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Governing for Growth in Georgia

ASSESSMENT OF THE INSOLVENCY SYSTEM IN GEORGIA

GOVERNING FOR GROWTH (G4G) IN GEORGIA

29 June 2015

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ACRONYMS

G4G	USAID Governing for Growth in Georgia
USAID	United States Agency for International Development
EBRD	European Bank for Reconstruction and Development
IOH	Insolvency Office Holder
MoJ	Ministry of Justice
NBE	National Bureau of Enforcement
WB	World Bank
GEL	Georgian Lari
UNCITRAL	The United Nations Commission on International Trade Law
RS	Revenue Service
JSC	Joint Stock Company
LTD	Private Limited Company (Limited Liability Company)

CONTENTS

EXECUTIVE SUMMARY

The Ministry of Justice of Georgia ("MoJ") has requested the USAID *Governing for Growth (G4G) in Georgia* project to perform an assessment of the Georgian insolvency system. The MoJ is currently considering amending the *2007 Law on Insolvency Proceedings* (the "Law")[1] and has formed an internal working group to prepare draft amendments in response to a widespread recognition that there are problems in its application and to its sparse utilization. The Deputy Minister of Justice requested G4G support in performing an evaluation of both the Law and the overall insolvency system to assist the ministry in its drafting efforts and to ensure that the resulting legislation will be more consistent with emerging "international best practices" for insolvency regimes. The results of the assessment[2] by the G4G team are set out in the following sections of this report.

LOW LEVEL OF USE OF INSOLVENCY PROCEEDINGS

It appears that the Law is utilized relatively infrequently as a tool to resolve financial distress in Georgia.[3] It is possible, as we have been told, that the Law's infrequent use is in part because of the stigma that still attaches to insolvency. However, another reason may also be because the Law, and the manner in which it has been interpreted, has not met the needs of either debtors or creditors in the current economy. As discussed further herein, the Law adversely affects the rights of senior secured creditors, largely ignores the rights of unsecured creditors, and does not provide a flexible enough framework for "rehabilitation" to be a useful strategy for either debtors or creditors. Managers and directors of companies facing financial difficulty might be more inclined to take timely insolvency action if the legal framework were to provide appropriate incentives to encourage sooner intervention and better overall practice. In the context of financial distress, the sooner action is taken, the more options there are to address the problem.

PRINCIPAL FINDINGS

The report's most significant findings are summarized below:

- The stated purpose of the Law is not expressed in terms which maximize the protection of creditors' rights or of the net value of the debtor's assets. The stated purpose of the Law, "…to equally protect the rights of a debtor and of a creditor (creditors)," is unusual in the emphasis that it gives to the debtor. Insolvency laws are more commonly thought of as providing a collective mechanism for creditors to maximize the recovery of amounts due to them when the debtor is unable to generally meet its contractual obligations when they become due. While reorganization of the debtor's business is generally considered preferable to the outright sale of the debtor's assets, reorganization is best viewed as a strategy to maximize the value of the debtor's assets for the benefit of its creditors, rather than an end in itself. Such a change in the orientation of the legislation will require substantial redrafting.
- The lack of clarity in the responsibilities of the Insolvency Office Holder ("IOH") and the debtor significantly hinders the maximization of the value of the insolvent debtor's assets.
- It is not clear in the Law that the protection of the net asset value of all of the debtor's assets for the benefit of the pre-insolvency creditors is the most basic of the trustee's responsibilities.
- The National Bureau of Enforcement ("NBE") in its role as trustee, does not appear to be organized in such a way as to effectively allow it to protect the intangible assets of an insolvent debtor, including accounts receivable. The IOH has an obligation to protect the value of all intangible assets of the debtor, as well as the real and moveable tangible assets. Where it lacks the specialized expertise to convert a particular type of asset

[1] All references herein are to the *Law of Georgia on Insolvency Proceedings*: Parliament of Georgia, 28th of March 2007, (No: 4522-IS), as amended 11th of December 2014 (No: 2922-IS) unless otherwise indicated.

[2] We wish to note the excellent cooperation our team received from the Georgian Ministry of Justice, and its agency, the National Enforcement Bureau, in particular the NBE's openness and candor in discussing the many challenges they face in carrying out the complex requirements under difficult circumstances on a day-to-day basis.

[3] *See chart in Appendix G, displaying the few case filings in number (approximately 25 – 100 per year) relative to business registrations (approximately 10,000 – 20,000 per year).*

(accounts receivable, for example) into cash, the IOH should be able to engage such experts to assist it.

- The Law fails to establish a framework to ensure that people performing IOH roles are accountable, competent, honest, or have the necessary experience. Protecting the assets of the debtor for the benefit of the creditors is a complex and difficult role, which requires a broad understanding of the laws which affect an insolvent business, as well as sufficient business knowledge to deal with the debtor's assets effectively.
- The lack of rigorous qualifications and experience required by parties who carry out the duties of an IOH remain unaddressed since the 2009 European Bank for Reconstruction and Development ("EBRD") survey which previously identified these deficiencies.
- The NBE, in carrying out its responsibilities in insolvency cases, should seek specialized technical training for the staff of its Insolvency Department.
- The MoJ should also consider developing a mid-term strategy to convert the Insolvency Department of the NBE into a regulatory body for the oversight and licensing of private sector IOHs.[4]
- The use of mandatory auction as the exclusive sales method for assets in bankruptcy cases is not always the most effective method for realizing the highest net value. Other suitable mechanisms for disposal of assets in a transparent and appropriate manner should be included in an amended law, including the power to sell perishable and time-dated inventory.
- The relatively few articles which comprise the Law leave many common situations unaddressed. This lack of detail in the Law to address specific issues impacts efficient case resolution and the ultimate realization of asset values. There is often no legal basis provided to protect the interests of either creditors or the debtor in certain common situations. For example, the Law does not contain provisions:
    - That require public utilities to continue to provide essential services;
    - Regarding the rights of the IOH and creditors when there are goods in transit at the time a proceeding is opened;
    - That allows the IOH to effectively recover assets divested by the debtor immediately before the insolvency proceeding is opened;
    - That specify whether and under which circumstances the IOH can temporarily continue some of the operations of the debtor in order to protect the value of the assets;
    - That specify under what circumstances the IOH can sell perishable or time-dated inventory urgently, to protect their value.
- The lack of precision in the current Law has also led to its inconsistent application by the courts in numerous instances.
- The grouping of all secured creditors into a single rank of creditors seriously undermines the principle of "first-in-time" to register collateral, which is a foundational rule generally used to establish priority of mortgage charges and liens in modern commercial usage globally. This important principle of determining the priority of mortgages, liens and other types of security fails to apply once an insolvency proceeding has been opened. Instead, in certain circumstances, the claims of all secured creditors are "pooled," together and treated as though all secured creditors had the same rights irrespective of priority. Besides lacking fairness, this treatment increases the level of uncertainty and unpredictability for lenders, which negatively impacts the cost and availability of credit to all borrowers. This treatment is inconsistent with international best practices.
- Ineffective provisions in the Law regarding rehabilitation plans restrict the use of business rescue as a tool to maximize value. In particular:

[4] *Georgia is the only country in the EBRD survey in which the IOH is a government agency; other countries have opted for solutions in which private sector individuals and sometimes legal entities are appointed to IOH roles, subject to varying degrees of oversight.*

- The rehabilitation provisions of the Law lack fairness, in that the unsecured creditors are not entitled to vote on a plan that affects their rights profoundly;
- The rehabilitation provisions of the Law require *full* settlement of the claims of all creditors. This in sharp contrast to the more usual requirement that a plan may propose *less than full* recovery, subject to creditor agreement expressed by vote, with the typical safeguard that the plan should provide at least as great a recovery by all ranks of creditors as they would realize from the outright sale of the debtor's assets. The Law should be amended to allow rehabilitation plans to offer less than full settlement of the claims of each rank of creditors, subject to the requirement that no class of creditors is worse off under a plan than they would be if the debtor's assets were sold.
- The large number of ranks of creditors, the claims of which must be satisfied before any distribution can be made to the next rank, means that the lower ranks of creditors are likely to have to wait a considerable period before they receive any amounts due to them. Where there is a structure with many ranks of creditors, the most junior creditors may well prefer to a smaller but much earlier recovery which will result if the assets of the debtor are sold. Such a tiered structure of many ranks of creditors is less likely to have the support of junior unsecured creditors than a structure with fewer ranks. The number of ranks should be reduced, and in particular, provisions allowing for the satisfaction of small "administrative convenience" claims be added.
- The claims of the government (typically unpaid taxes) should be treated as a general unsecured claim, as laws that grant the state a superior priority in a bankruptcy distribution have fallen out of favor in modern international practice. Granting a high-priority status to state claims only creates a strong disincentive for this highly-privileged creditor to ever vote in favor of a rehabilitation plan, instead preferring a bankruptcy distribution where the state will immediately be paid in full. Conversely, this same scenario also creates a strong incentive for the more junior and unsecured creditors to opt for rehabilitation solely to avoid the state immediately taking all in a bankruptcy distribution thereby leaving little remaining for them.

PROPOSED AMENDMENTS

After the conclusion of the fieldwork for this assessment, the team received a set of proposed amendments to the Law from the MoJ on 22 May, 2015. While some of the proposed amendments address certain concerns raised in this report, such as an all-creditor vote on a rehabilitation plan, the proposed amendments generally do not address all the issues identified. Certain fundamental issues remain unaddressed, including: the purpose of the Law, the preservation of the relative ranking secured creditors, as well as the lack of clarity regarding the basic primary functions of the NBE in its role as trustee. While the proposed amendments are a welcome improvement, we believe considerably more will need to be done to fully address the fundamental issues raised in this report.

EARLY DISMEMBERMENT OF THE DEBTOR

The data provided by the NBE on the open insolvency proceedings (included as Appendix C) suggest that in many proceedings the banks have been successful in having the debtor transfer its real assets to the banks' names before the opening of an insolvency proceeding. This has the effect of dismembering the debtor's "going concern value" and making the prospects of a successful rehabilitation plan remote. If so, this should be addressed by new amendments containing provisions covering preferential transfers. Because the information from the NBE was made available after our fieldwork ended, the team was not able to fully examine whether the banks recovered more than amounts due to them when the debtor's real assets were transferred to bank ownership.

NEED FOR A SUBSTANTIALLY NEW LAW

Based upon our current review, we find that the current insolvency system in Georgia, regulated by the *2007 Law on Insolvency Proceedings,*[5] possesses significant legal and economic weaknesses. Stronger policies underlying the legislation that governs the insolvency system are needed to create a more effective environment for the resolution of financial failure in Georgia. Addressing these and other issues raised in the main body of the report are likely to require a major redrafting or an altogether new law if it is to achieve close consistency with emerging norms of international best practice[6] for national insolvency systems.

[5] *See note 1 above.*

[6] One example and source of emerging international norms is the World Bank's "*Principles and Guidelines for Effective Insolvency and Creditor Rights Systems*": World Bank publication, April 2001. Another excellent guide is the "*Legislative Guide on Insolvency Law*": United Nation Commission on International Trade Law (UNCITRAL), 25 June 2004, UN publication, (Sales No. E.5.V.10, ISBN 92-1-133736-4).

INTRODUCTION, METHODOLOGY AND BACKGROUND

INTRODUCTION

Governing for Growth (G4G) in Georgia is a five-year multi-million dollar USAID project designed to support the Georgian government to create a better enabling environment in which legal and regulatory reforms are fairly and transparently conceived, implemented and enforced through consultative dialogue. G4G is comprised of five components, one of which is Component 2: Strengthening Government Capacity to Develop, Implement and Enforce Reforms. This report was prepared within the frame of Component 2 of the G4G project. This capacity strengthening component focuses on different policy reforms in order to comply with international standards, improve the business enabling environment and raise Georgia's economic competitiveness. G4G supports government institutions to strengthen their capacity by providing technical assistance and training to support the process of reform development, implementation and enforcement. This insolvency assessment falls within this capacity building component.

METHODOLOGY

This report sets out the results of the G4G team's assessment, the fieldwork for which was carried out between April 15 and May 8, 2015. Its primary purpose was to identify basic areas in the Law and system which, in our view, are not operating effectively or are not consistent with emerging international best practices for insolvency systems. Because of the short period over which the assessment has been carried out, it has necessarily focused on the major deficiencies and departures from "best practice," and is limited in its comprehensiveness. It is intended to be more descriptive than prescriptive.

One of the main inputs to this assessment has been a series of interviews with a number of people deeply familiar with the functioning of the Law in practice. Several of these participants were also generous enough to provide written commentaries on their observations and concerns to further enhance our understanding of how the insolvency system currently works. (A list of the participants interviewed is attached to this report as Appendix A.) We have also reviewed reports and analyses recently performed by international organizations to determine whether deficiencies identified therein remain.

On May 8, 2015, the G4G team held a working conference with its contributors in the form of a public-private dialogue to discuss in general terms the tentative results of our assessment, to ensure that we had identified the major areas of concern and, importantly, that with our limited understanding of the overall functioning of the Georgian legal system and broader economy, we had not misunderstood some critical issues.

In addition, we referred to the Georgian laws which are affected by, or which affect, the subject Law on Insolvency Proceedings; to the insolvency laws of other developing economy countries which have recently re-written their insolvency laws more closely toward international best practices; to the assessments carried out by the EBRD and World Bank, as well as background material on the economy and legal environment in Georgia.

The team also referred to the World Bank publication "*Principles and Guidelines for Effective Insolvency and Creditor Rights Systems;*"[7] the EBRD *"Core Principles for an Insolvency Law;"*[8] and the UNCITRAL "*Legislative Guide on Insolvency Law*."[9] These documents are amongst the key standard references to what can be called "International Best Practices" for national insolvency systems. We urge all parties who have an interest in possible amendments to the Law on Insolvency Proceedings to consult these documents closely.

The proposed amendments being prepared by the working group within the MoJ were provided to the G4G team on May 22, 2015, after the conclusion of our field work. As a result, we were not

[7] *See note 6 above.*

[8] *"Core Principals for an Insolvency Law,"* European Bank for Reconstruction and Development (EBRD), January 2005. Document found at: http://www.ebrd.com/downloads/legal/insolvency/principle.pdfdocuments/profiles/country/GEO.pdf

[9] *See note 6 above.*

able to discuss the proposals and suggestions herein with the drafters. However, the report below includes references to the proposed amendments as they relate to the issues raised.

On occasion we have encountered more than one translation into English of important laws we have used in our assessment, and these translations sometimes differ in important respects. We have made every effort to ensure that our assessment has been based on a correct translation from the Georgian original, but recognize that there may be instances where an inaccurate translation has led us to an insufficiently nuanced observation.

The G4G team recognizes that Georgia has faced many economic challenges since it obtained its independence in 1991, and that these have affected both its current economic environment, and the objectives of its legislative priorities in the past. The G4G team also understands that an insolvency law and system do not operate in the abstract but must serve the needs of the emerging economy, consistent with the realities and circumstances present in the country.

BACKGROUND

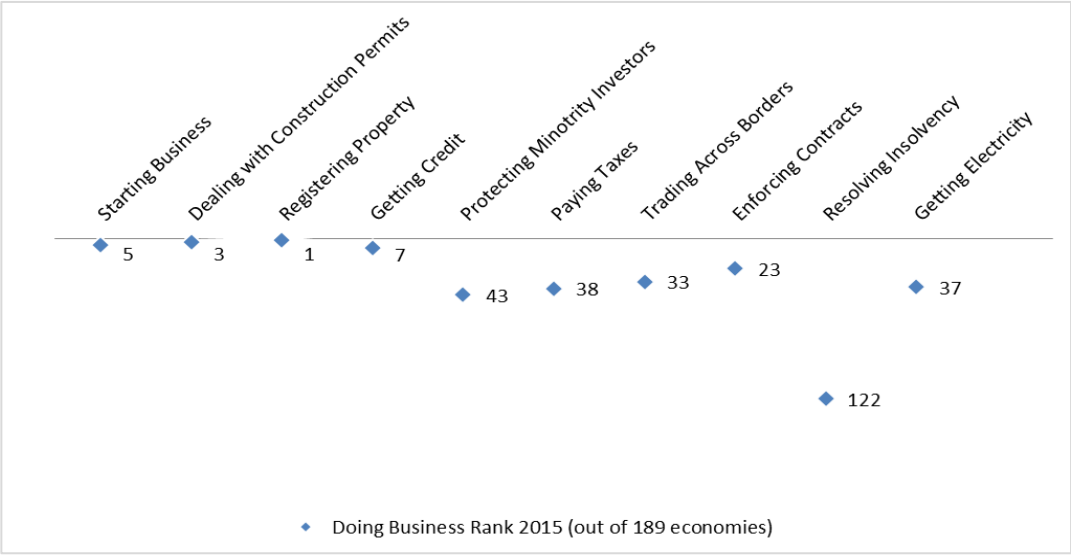
In January 2015 the Deputy Minister of Justice requested the G4G project to conduct an assessment of the insolvency system in Georgia. The ministry had previously formed an internal working group to draft amendments to the law in response to a commonly-voiced concern that the Law on Insolvency Proceedings was not functioning well, and was sparsely utilized. It is intended that G4G's assessment will be used as input for draft amendments to the law.

A further impetus for reform has been the recent evaluations by the World Bank and EBRD of the Law or aspects of the Georgian insolvency system which have cited numerous systemic weaknesses and deficiencies. A brief summary of three evaluations is provided below.

WORLD BANK 2015 DOING BUSINESS SURVEY[10]

Georgia has an exemplary overall record of reform over the last decade and more, a record that is reflected in its being ranked 15 out of 189 economies in the 2015 "Doing Business" survey conducted annually by the World Bank. However, in the "Resolving Insolvency" sub-category of the survey, Georgia ranked a poor **122 out of 189** economies which had insolvency regimes evaluated in 2015. See Appendix E.

Figure 1: Doing Business 2015 - Georgia[11]

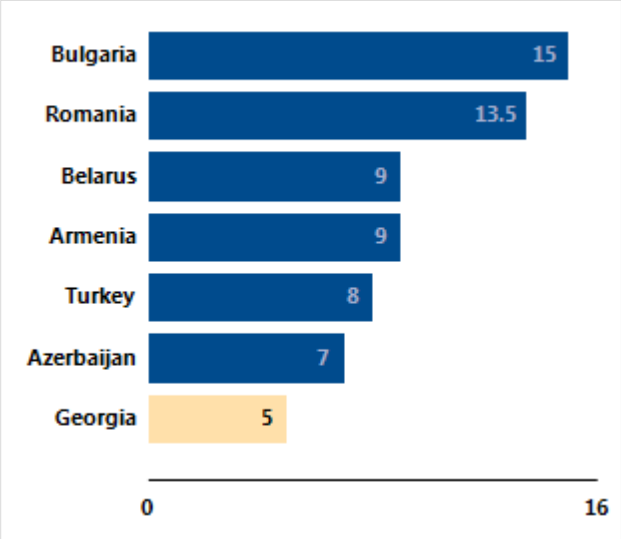


[10] The World Bank, *Doing Business 2015: Going Beyond Efficiency*, Washington, DC: World Bank Group. DOI: 10.1596/978-1-4648-0351-2. License: Creative Commons Attribution CC BY 3.0 IGO. The survey results may be found at: http://www.doingbusiness.org/data/exploreeconomies/~/media/giawb/doing%20business/documents/profiles/country/GEO.pdf

[11] Prepared by G4G from data provided by The World Bank, *Doing Business 2015, ibid.* This chart is an adaptation of original work by The World Bank. World Bank points out that only 169 of the 189 overall economies evaluated had insolvency regimes or provided enough information to perform an insolvency evaluation.

Moreover, on the sole factor of overall *Strength of the Insolvency Framework*, Georgia fared worst among the local regional economies.

Figure 2: Strength of insolvency framework index (0-16) – Georgia[12]



The primary reasons cited for the poor World Bank ranking were the low scores on certain of the individual factors measured, most notably, those that follow:

- *Management of debtor's assets index* (2.5 out of 6) (Deficient factors: provision for the continuation of essential supply contracts; rejection of overly burdensome contracts, avoidance of undervalued transactions);
- *Reorganization proceedings index* (0 out of 3) (Deficient factors: which creditors vote; dissenting creditor protection; appropriate creditor classification for voting);
- *Creditor participation index* (1.0 out of 4) (Deficient factors: creditor approval sale of substantial assets; creditor right to requisition information; creditor right to object to other claims);
- *Strength of insolvency framework index* (5.0 out of 16).

EBRD 2009 INSOLVENCY LAW ASSESSMENT

In 2009, the EBRD Insolvency Law Assessment Project assessed the insolvency laws of 27 countries where the EBRD is active including Georgia.[13] This assessment also scored the Law poorly. To quote from the conclusions of this assessment:

> "*The assessed compliance score for the general insolvency law assessment was 63%, indicating low compliance… The assessed compliance score for the IOH Assessment in this area was 27%, indicating very low compliance*." [14]

A careful review of the EBRD assessment suggests that the degree of compliance for the "general assessment" should probably have been even lower, as the answers given in some cases depended on which of the three IOH positions (Trustee, Bankruptcy Manager or Rehabilitation Manager) the respondents were referring to in their responses. (It should be noted here that Georgia is unusual in having three different IOH roles; in most jurisdictions familiar to the G4G team, a single party fills the role that the Trustee and Bankruptcy Manager fills in

[12] *See note 5 above, page 78.*

[13] *Insolvency Law Assessment Project – 2009, Georgia.* European Bank for Reconstruction and Development (EBRD) 2009. A copy of the summary of the EBRD evaluation for Georgia is attached as Appendix B.

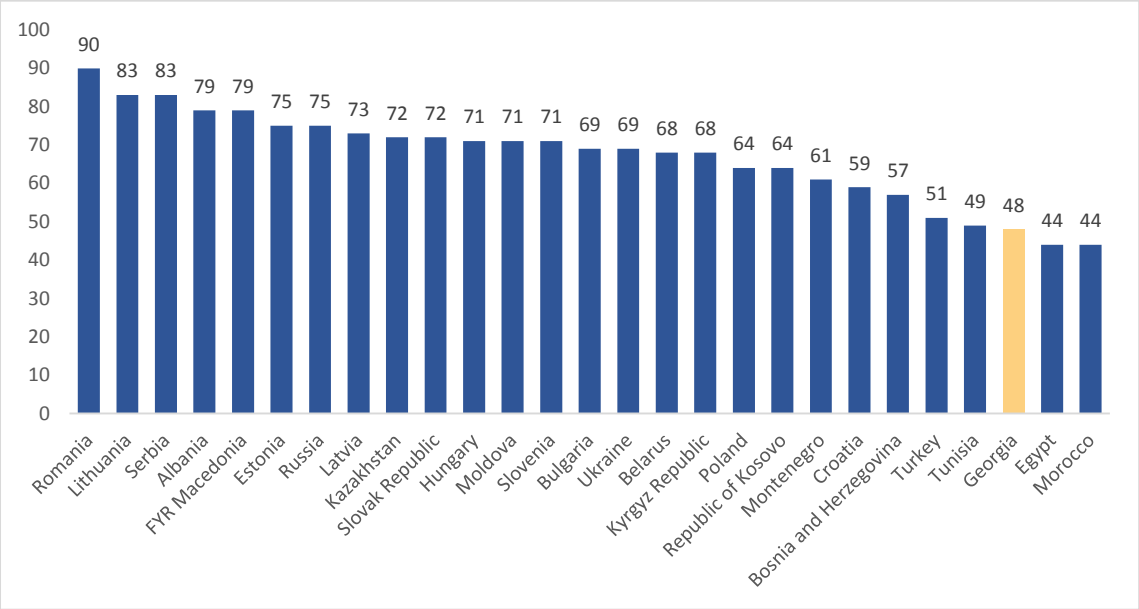
[14] "Compliance" is defined by the EBRD as: "[The] level of compliance of insolvency laws with international standards, such as the World Bank's Principles and Guidelines for Effective Insolvency and Creditor Rights systems, the UNCITRAL working group on legislative guidelines for insolvency law, and others." Source: http://www.ebrd.com/what-we-do/economic-research-and-data/data/forecasts-macro-data-transition-indicators/methodology.html

Georgia). The Law on Insolvency Proceedings has not been substantially amended since 2009, and the shortcomings noted in the EBRD 2009 assessment remain unaddressed.

EBRD 2014 IOH ASSESSMENT

The EBRD 2014 IOH Assessment ranked Georgia's development of the office holder profession as 25 out of 27 countries surveyed, last except for Egypt and Morocco.

Figure 3: Development of the IOH profession in transition countries[15]



The EBRD evaluation report stated: *"The weakest overall framework for IOHs appears to exist in Egypt, Morocco, Georgia and Tunisia where only a few key elements of the profession are covered."*[16]

The basis for the low evaluation in the EBRD survey is consistent with our findings, particularly in terms of regulation, oversight and training of those with responsibility for the conduct of insolvency proceedings.

[15] *Assessment of Insolvency Office Holders: Review of the Profession in the EBRD Region*, European Bank for Reconstruction and Development, 2014, at page 18: http://www.unpir.ro/downloads/doc-banere/Raport%20de%20evaluare%20BERD%20privind%20reglementarea%20profesiei%20de%20practician%20in%20insolventa%20in%2027%20de%20tari.pdf

[16] Ibid, page 19.

SUMMARY OF INSOLVENCY PROCEEDING STATISTICS

There are two courts authorized to conduct insolvency proceedings in Georgia; four judges in the Tbilisi City Court conduct all such proceedings in eastern Georgia, while in the Kutaisi City Court a single judge hears insolvency proceedings in western Georgia. There were 51 open insolvency proceedings in the Tbilisi City Court at the end of March 2015.

In the period from 1 January 2009 to 31 March 2015, there were 315 applications to the Tbilisi City Court to open an insolvency proceeding. Of these 315 applications, 233, comprising 74% of all applications, were rejected or suspended. The judges interviewed indicated that the primary reason underlying this high rate of rejection is that the debtor did not have enough assets to pay for the costs of the proceeding (in other words, the case were "administratively insolvent").

Table 1: Number of Insolvency Proceedings per Year - Tbilisi City Court[17]

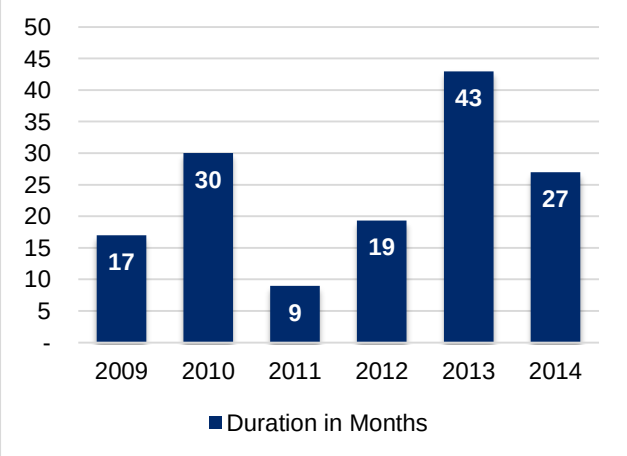
Period	Cases Carried Over	Cases Filed	Cases Rejected / Suspended	Cases Closed	Cases Open at Year End
2009	23	28	17	3	31
2010	30	36	23	16	27
2011	27	31	16	8	34
2012	33	49	32	18	32
2013	32	53	45	5	35
2014	35	97	86	2	44
2015 (Q1)	44	21	14	-	51

Table 1 contains a summary of the number of proceeding processed each year by the Tbilisi City Court. Figure 4 presents the average duration to fully administer the proceedings, categorized by the year in which the proceedings were closed. The results show that the average duration of a proceeding exceeds the time limits mandated by Article 5 of the Law, often by a wide margin. We were unable to establish the precise reasons for these delays during our review. Further research would be necessary to help identify specific areas where the courts have not been able to operate as expeditiously as the Law envisages, which may give rise to a number of additional amendments.

The team was unable to interview the lone judge in the Kutaisi City Court who administers insolvency proceedings, but it would appear based on the NBE record of the total open proceedings in Georgia and the number of that the Tbilisi City Court is conducting, that the Kutaisi City Court has 4 open proceedings.

In addition to the statistics provided by the Tbilisi City Court, the NBE provided the team with data on 55 insolvency proceedings open as of mid-May 2015. Appendix C contains an extract of the statistical data provided to the team by the NBE.

Figure 4: Duration in Months of Closed Cases[18]



[17] Source: *Tbilisi City Court Statistics Department.* The Department could not provide an explanation for the lack of continuity contained in the table above.

[18] Source: *Tbilisi City Court Statistics Department.*

CONCLUSIONS FROM THE NBE DATA ON OPEN INSOLVENCY PROCEEDINGS

The data in Appendix C indicates, amongst other things, that for the 55 proceedings:

(i) **The Georgian government is the largest creditor.** The claims of the Revenue Service ("RS") comprise 48% of all secured claims and 32% of all claims. In 14 proceedings, the RS claims make up between 90% and 100% of all claims.

(ii) **Rarely do unsecured creditors realize any recovery.** In only 7 of 55 open proceedings are the unsecured creditors expected to realize any recovery at all on their claims; included in the 7 are Joint Stock Company ("JSC") "*Kakheti Energodistribution,*" where the dominant unsecured creditor is ESCO, a state owned company, and Private Limited Company ("LTD") "*Tskalkanali XXI*," whose accounts receivable have not been assessed. In short, the present law operates for the benefit of the RS more than for any other creditor or group of creditors.

(iii) **Assets are already disposed of by the opening of the case.** There are only four proceedings where the value of the assets of the debtor (the "trusted property") exceeds 5 million Georgian Lari ("GEL"). From this it would appear that in many proceedings the assets of the debtor have been transferred to bank creditors or some other party before the proceeding is opened (*LTD "Ioli" Supermarket* and *LTD "Sky Georgia"* are examples of debtors which have nominal assets, but liabilities of many million GEL). We were unable to determine precisely how the assets were transferred.[19] The business of the debtor may have been effectively dismembered well before the insolvency, leaving little opportunity for an effective reorganization at that stage.

(iv) **Whole categories of assets are not protected or converted to cash.** There are a large number of proceedings, some dating back several years, where the accounts receivable "could not be evaluated." For example, *LTD "New City,*" a proceeding which was opened on January 9, 2014, apparently has or had accounts receivable of some 2,732,682 GEL which "could not be evaluated." This situation strongly suggests that the NBE does not have the expertise to either value or collect the accounts receivable of the debtor. Such a situation seriously prejudices the debtor's creditors.

These points above further provide evidence that the insolvency system is not functioning optimally, nor serving the purpose of an insolvency system well.

LOW LEVEL OF USE OF THE LAW ON INSOLVENCY PROCEEDINGS

The team was not able to answer with any certainty the question posed by the Deputy Minister of Justice, as to why the Law on Insolvency Proceedings is used so infrequently. As noted above, the EBRD found that the majority of respondents did not consider that the commercial insolvency proceedings played an important role in Georgia. The team speculates that this perception arises from both a stigma in the commercial community to being declared "bankrupt," and from the problems with both the design and application of the present law.

From a creditor's perspective, the following might be relevant:

- A creditor must have a relatively large claim and be prepared to make a substantial up-front deposit for court and state fees at the same time as it makes its application to open proceedings. It is not clear from the Law whether or not all the fees required to be paid by the creditor represents a cost that is classified as being in the second rank of creditors, or whether the cost is simply another unrecoverable cost to the creditor.

- At this stage of the development of the Georgian economy, we speculate that most small businesses are financed by savings and informal sources of funding, and that it is only medium and larger enterprises which are able to obtain bank financing. To the extent that bank financing is largely secured by charges on real property, the banks have other

[19] Because the team received the NBE data after the close of its field work, we were unable to inquire whether the assets had been transferred to the debtor's bankers before the opening of the proceeding, or another party in an attempt to put the assets out of the reach of the debtor's creditors.

effective remedies if their borrower defaults. The relative low level of bank indebtedness and high level of indebtedness to the RS in open insolvency proceedings in which the NBE is acting as IOH suggests that the banks have been successful in transferring the main assets of the debtor to themselves before the proceedings are opened.

- Because the priority position of the bank's charge against any given piece of real property cannot be assured once an insolvency proceeding has been opened, the banks, as senior lenders, will be positively opposed to any such proceedings.

- The data provided to the team indicates in only 7 of the 55 open proceedings do the unsecured creditors have any possibility of any recovery at all. It would not be surprising if the unsecured creditors did not think that the Law on Insolvency Proceedings was relevant to them.

- There may be better rehabilitation plans that could be formulated that would return more to the unsecured creditors than bankruptcy, but without information or the ability to vote on any plan, the unsecured creditors are likely to remain uninterested in the process, even though their rights may be profoundly affected.

- It is also likely that creditors are skeptical that the NBE in its role as trustee (and often bankruptcy manager) will protect their interests. The NBE is reportedly viewed as an institution that is unaccountable to the creditors, but which cannot be replaced as trustee or Bankruptcy Manager.

Further, although both the Civil Code and the Criminal Code contain provisions which set out penalties for managers/owners who damage "the company" or the creditors (presumably, by not timely filing for insolvency), these are not enforced. If these provisions were rigorously enforced, managers of companies in financial difficulty might be more inclined to take timely action for insolvency to prevent further damage to these parties. In an insolvency context, the sooner action is taken when a business suffers financial distress, the more options it has to fix the problem.

It is unlikely that insolvency will become accepted as a normal part of commercial activity in Georgia for some time. However, changes to the law that address the issues raised in this document, and in our separate report, should improve the perception of, and hence the use of, the insolvency system.

PURPOSE OF AN INSOLVENCY SYSTEM

The general purpose of an insolvency law is to establish a collective legal mechanism for the settlement of creditors' claims in a single legal proceeding through which unsecured creditors can maximize the recovery of amounts owed to them.[20] A properly functioning modern insolvency system provides a fair, transparent and certain legal framework for viable firms to reorganize where possible, and an orderly means of exit from the marketplace for firms that cannot.[21] It is a legal mechanism that can be invoked in place of the individual enforcement rights normally available under other non-bankruptcy laws in situations where the debtor is unable to service its obligations according to its contractual terms. A well-functioning insolvency law envisages an orderly collection and distribution of assets, after conversion to cash, preventing a race by creditors to dismember the debtor. As such, all insolvency laws inherently strike a balance between a number of design choices, the most important of which include:

- The relative emphasis on rehabilitation, or on the sale of the debtor's assets.

- The division of powers between the main parties, namely the debtor, the insolvency administrators or equivalent office holder, the court and the creditors (sometimes represented through a creditors committee).

Importantly, proper insolvency proceedings contemplate fair and equitable treatment of *all* creditors based upon their rights and priorities at law. A well-functioning insolvency law

[20] Adapted from, *Bankruptcy Practice Manual*, USAID Publication, January 2005. (ISBN 86-906645-0-5).

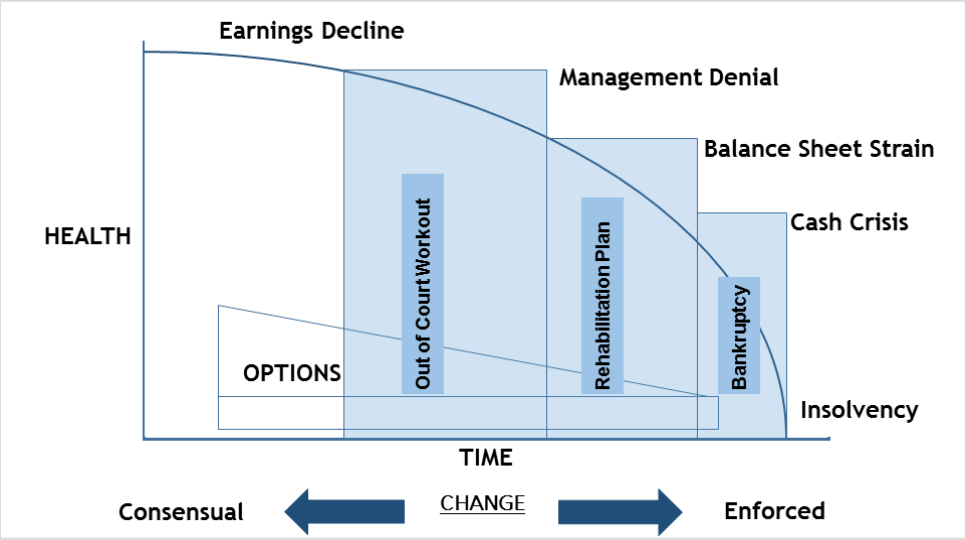
[21] Ibid.

recognizes and *preserves creditor pre-insolvency priorities to the greatest extent possible*, whereby the relative rights of different types of creditors, secured and unsecured, will not be changed solely as a result of an insolvency. Georgia, at present, has not yet created such a system.

THE PROCESS OF BUSINESS DECLINE BEFORE AN INSOLVENCY PROCEEDING IS OPENED

To put insolvency in perspective, relatively few mature operating enterprises fail each year.[22] Sustainable businesses operate year after year in a commercial legal environment shaped by other laws covering contracts and contract enforcement, employment, and banking and collateral laws. It is only when a business begins to decline that the insolvency system becomes important. The graph below demonstrates the process, and the appropriate responses, as a business begins to fail.

Figure 5: The Business Decline Curve[23]



Several observations can be made from consideration of this graph that are important for setting the context for a bankruptcy system:

- When earnings begin to decline, the management begins to come under pressure to take corrective action. If the earnings decline continues, management should urgently consider negotiating an out-of-court restructuring with it largest creditors. However, this seldom happens in most economies as managers seldom recognize the severity of the problem when things first begin to go wrong, hence the "Management Denial" caption in the graph. Currently, Georgia does not have a formalized out-of-court workout regime, nor has it adopted any formal workout guidelines.

- Decline is not linear. When a business declines, it tends to decline increasingly quickly. The options available to management to correct the deteriorating situation disappear rapidly. Trade creditors are likely to restrict terms on which goods will be supplied to the point where delivery of goods will only be made against pre-payment, if at all. This increases the business' need for cash at a time when it is already having increasing difficulty generating cash from operations.

- By the time a business has reached the "cash crisis" stage, its "going concern value" has been significantly diminished (customers do not shop at a business whose shelves are empty, key employees depart, trade suppliers refuse to provide goods, and so on).

[22] This does not refer to new business start-ups.

[23] *Business Decline Curve* as presented by Begbies Traynor.

- As a result, by the time insolvency proceeding is opened, a debtor's "going concern value" has usually been severely diminished. The result is twofold:
  - In the overwhelming number of proceedings, the assets of the debtor are sold for considerably less than their previous "going concern value," and;
  - Successful formal rehabilitation plans governed by insolvency legislation are very rare. This applies regardless of the size of the debtor, although large debtors are more likely to have the resources needed to formulate a successful plan.

Understanding the cycle and dynamics of business decline curve is important to the development of any appropriate legal regime tailored to address the debtor business situation at the varying phases effectively. The three critical phases are:

- **Out of Court Workout.** The ability to engage in a constructive negotiation for the reprogramming of the terms of loans or other credit between the debtor and its main creditors on a voluntary basis without the resort to formal court proceedings.
- **Reorganization (rehabilitation).** The legal mechanism to permit the formulation of a plan to address the payment of the debtor's obligations subject to creditor approval (creditor vote) via collective proceeding, typically under court supervision.
- **Bankruptcy (liquidation).** The gathering of debtor's assets and conversion to cash by an official for the payment of unsecured debts fairly, efficiently and transparently to the fullest extent possible, typically under court supervision.

Given the typically rapid deterioration in going concern value, along with the corresponding narrowing of options that generally occur when business faces financial difficulty (illustrated in the *Decline Curve* above), it is critical to have a legal regime that invites a debtor business facing financial difficulty to invoke remedies sooner rather than later while there is still a viable business to reorganize or value left to preserve. These can be negative incentives, such as civil or criminal sanctions for damaging the creditors, as well as an insolvency system which offers realistic restructuring options.

We note that the present system in Georgia does not provide effective alternatives that invite early interventions that preserve asset values, provide realistic chances for reorganization, or maximize creditor recoveries. Currently, no non-court informal workout regime exists to guide debtor-creditor negotiations that would typically occur in the early stages of financial distress. As such, it might be beneficial to explore the possibility of adopting an out-of-court work-out regime or relevant guidelines, such as those proposed within INSOL International's *Statement of Principles to a Global Approach to Multi-Creditor Workouts.*[24]

BRIEF HISTORY OF INSOLVENCY LEGISLATION IN GEORGIA

The choices made by an individual country will reflect its political and social culture, as well its economic history and conditions. In Georgia's case, upon independence, the country faced a steep decline in GDP followed by a rapid restructuring of its economy from a centrally-planned system to one that is market-based, followed, in turn, by the conflict of 2008. This history has likely shaped the insolvency system that exists today.

The first insolvency legislation in Georgia, the *Decree of the State Council of Georgia on the Bankruptcy of Enterprises,*[25] dated September 8, 1992, was enacted shortly after Georgia gained its independence in 1991. This decree was an abridged version of a Russian Decree with the same name. The Decree was apparently regarded as 'impractical' at the time, when one of the key concerns of the government was a major effort to privatize the major state owned enterprises which dominated the economy. Insolvency proceedings were apparently not considered relevant in meeting these challenges. In June 1996, the *Law on Bankruptcy*[26] replaced the *Decree of*

[24] *INSOL International Lenders Group Steering Committee*, October 2000. (ISBN-10: 1907764100).

[25] *Decree on the Bankruptcy of Enterprises*: State Council of Georgia, 8 September 1992.

[26] *Law on Bankruptcy: Parliament of Georgia*, 25th of June 1996. (No: 286); https://matsne.gov.ge/ka/document/view/652, as amended: 28th of March 2007.(No: 4522).

1992. The team was advised that this law was patterned after the insolvency law in place in Germany at the time. It is important to note that the Georgian 1996 law was drafted slightly before the German law itself underwent a major revision. In 2007 the *Law on Insolvency Proceedings* replaced the 1996 Law on Bankruptcy.

The most substantive amendment to the 2007 Law was made in 2011, with a clause that stipulated that the NBE was required to be appointed as trustee whenever an insolvency proceeding was opened. The NBE was also required to be appointed as Bankruptcy Manager in the event that the creditors were unable to appoint another party at the creditors meeting. Another substantive 2007 amendment designated the auction department of the NBE as the sole organization authorized to sell the assets of a bankrupt debtor.

GENERAL OVERVIEW OF OTHER LEGAL ACTS IN RELATION TO INSOLVENCY PROCEEDINGS

Civil Code of Georgia[27]

The Civil Code regulates property, family and personal relations of a private nature, on the basis of the legal equality of persons. The main objectives of the law in relation to insolvency proceedings are as follows:

- Govern the reorganization of non-entrepreneurial (non-commercial) legal entities;
- Define non-registered unions (association);
- Establish grounds for termination of partnerships;
- Describe the procedure for termination of partnerships;
- Specify the first two classes of legal heirs.

Civil Procedure Code of Georgia[28]

Common Courts of Georgia review civil matters under the procedures determined by the Civil Procedures Code. The main objectives of the Code in relation to insolvency proceedings are as follows:

- Prescribe rules of judicial summons and subpoenas served to debtor and creditors;
- Prescribe rules of termination of insolvency proceedings;
- Defines the term “Relative”;
- Provisions of the Civil Procedure Code of Georgia apply if a specific issue is not regulated by the Law on Insolvency Proceedings.

Law on Entrepreneurs[29]

This Law regulates the legal forms of the subjects of entrepreneurial activity. The application of the Law on Entrepreneurs in relation to insolvency proceedings is as follows:

- Prescribe rights of the Bankruptcy Manager;
- Determine business entities subjected to the law on insolvency;
- Prescribe rules of registering court decisions.

[27] *Civil Code of Georgia*: Parliament of Georgia, 24th of July 1997. (No: 786); https://matsne.gov.ge/ka/document/view/31702, as amended: 1st of May 2015. (No: 3532-IIs).

[28] *Civil Procedure Code of Georgia*: Parliament of Georgia, 14th of November 1997. (No: 1106); https://matsne.gov.ge/ka/document/view/29962, as amended: 5th of June 2015. (No: 3666-IIs).

[29] *Law on Entrepreneurs*: Parliament of Georgia, 28th of October 1994. (No: 577); https://matsne.gov.ge/ka/document/view/28408?impose=original, as amended: 22nd of April 2015.(No: 3419-IIs).

Criminal Code of Georgia[30]

The Criminal Code establishes grounds for criminal responsibility and determines acts which are classified as criminal. It also imposes corresponding punishments or other criminal measures. The main objectives of the law in relation to insolvency proceedings are as follows:

- Stipulate types of penalty for different criminal acts;
- Set custodial sentences for criminal wrong-doing;
- Set the level of fines;
- Define illicit practices in relation to bankruptcy;
- Regulate breach of rule on failure to maintain books and records in the case of bankruptcy;
- Prescribe penalties for the failure to submit an application to open an insolvency proceeding when the debtor is unable to meet its contractual obligations.

The most relevant Criminal Code provisions[31] are as follows:

Article 205. Illicit practices in case of bankruptcy

Disposal or concealment of the part of the property in the course of insolvency for the purposes of making it inaccessible to a creditor, which, in the event of commencement of bankruptcy proceedings, would have fallen under the trusted property and, withal, damaging, rendering unfit or destroying it in defiance of the requirements for efficient management of economy, - shall be punishable by fine or by imprisonment for up to three years.

Article 205[1] Hiding the property by alleged or/and hypocritical agreements

1. Director, representative or person with other special authority of enterprise or other organization who hides the property by alleged or/and hypocritical agreements, regarding avoiding expected or/and already existed property obligations.

Penalties are: fine or 170-200 hours of work useful for society, or up to 2 years of reformatory work or 2-4 years of imprisonment.

2. The same action held by premeditated group of people

Is punished with fine or 4-7 years of imprisonment.

3. The same action, held with

A) Using official position

B) Large amount

C) Repeatedly

Is punished with fine or 6-9 years of imprisonment.

4. The same action held by organized group is punished 7-10 years of imprisonment

Notice: The large amount in this article refers to the price of hidden property made by alleged or/and hypocritical agreements, which is more than GEL 10,000.

Article 206. Breach of the rule of Account Book during the proceedings of the Insolvency

Breach of the rule of Account Book during the insolvency proceedings which made it harder to evaluate the price of the property is punished with fine or up to 2 years of imprisonment.

Article 207. Not filing the application of the commencement of the insolvency proceedings during insolvency process

The person with representative authority or liquidator during insolvency proceedings who does not file the application of commencement of the insolvency proceedings is punished with fine or up to 1 year of reformatory work or up to 1 year of imprisonment.

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[30] *Criminal Code of Georgia*: Parliament of Georgia, 22nd of July 1999. (No: 2287); https://matsne.gov.ge/ka/document/view/16426, as amended: 18th of May 2015. (No: 3529-IIs).

[31] Translation of the *Criminal Code* provisions appearing here are provided by G4G for discussion purposes only; we make no representation as to the completeness or accuracy.

Article 207.[1] The manager or the person having representative authority of the debtor who breaches the obligation to present the information to trustee

The manager or the person having representative authority of the debtor, who as it is established by procedures, fails to present information on debtor's assets, liabilities, financial position and activity, as well as failure to submit information on current court disputes, presenting information deliberately late or distorted information is punished with fine or up to 1 year of reformatory work or up to 1 year of imprisonment.

FINDINGS AND RECOMMENDATIONS

Pursuant to the request of the Ministry of Justice we have evaluated the text of the Law, statistics, structural elements, conducted interviews with officials and private parties involved with the insolvency system, and, using knowledge of current and emerging international best practices, produced the following findings and recommendations.

STATED PURPOSE OF THE LAW ON INSOLVENCY PROCEEDINGS

Many of the problems and issues encountered in the Georgian Law stem from the basic orientation of the Law, as it is embodied in its statement of purpose. Article 1 of the Law states:

> "The purpose of this law is to equally protect the rights of a debtor and of a creditor (creditors), to resolve future financial problems if possible and to satisfy creditors' claims, and if the latter is not possible – to satisfy creditors' claims via distribution of the amount."

In our interviews, the team found that the lack of consensus on the interpretation of the phrase "equally protect the rights of a debtor and of a creditor (creditors)" in the Law created a great deal of uncertainty in its application.

This language contrasts with Section 1 of the German Insolvency Statute, which states:

> "The insolvency proceedings shall serve the purpose of collective satisfaction of a debtor's creditors by liquidation of the debtor's assets and by distribution of the proceeds, or by reaching an arrangement in an insolvency plan, particularly in order to maintain the enterprise. Honest debtors shall be given the opportunity to achieve discharge of residual debt."

The German law clearly identifies the purpose of the law as the "collective satisfaction of the debtor's creditors" without reference to the "rights of the debtor," much less equating or elevating any such rights in some manner with the legally superior rights of the unpaid creditors. Where the assets of the debtor are not of sufficient value to settle the contractual claims of the creditors, then, by definition, the financial interest of the owner of the debtor has a negative value. In this situation, protecting and maximizing the legally superior creditors' financial interests takes precedence over the subordinate "rights" of the owner of the debtor to recover the value of any residual financial interest it might have. (Note that The World Bank "Principles and Guidelines for Effective Insolvency and Creditor Rights Systems;" does not make reference to the "rights of the debtor" in its title).

This reference to "*protect equally the rights of the debtor…*", found in the most fundamental statement of the Law's purpose, has often served to color the interpretation of many succeeding provisions of the Law which manifest many of the problems we have noted in this report. In several places, the Georgia Law itself, or interpretation, has resulted in elevation or diminishment of a creditor's legal priority in a manner that is inconsistent with international norms.

Moreover, the language of other articles in the Law suggests that the resolution of the debtor's "future financial problems" is the primary objective of the Law. By contrast, the maximization of payment of amounts due to the creditors, and especially the unsecured creditors, is not mentioned. The structure of the Law strongly suggests that the interests of the debtor are not only "equal" to those of the creditors, but are in fact superior to their interests. The unsecured creditors are put in position where, because the Law does not adequately distinguish creditors with different legal rights, they are likely to be outvoted by the secured creditors at the creditors meeting. Unsecured creditors are not given the opportunity to vote on a rehabilitation plan even though the plan may propose to profoundly affect their position, and are not entitled to even ask for information from the Rehabilitation Manager on the status of the plan once approved. While the secured creditors can participate in a meaningful way in a proceeding, the unsecured creditors as a group are effectively ignored. Again, this elevation or diminishment of a creditor's legal priority is inconsistent with international norms.

Recommendation: Article 1 of the Law should be amended to make explicit that the purpose of the law is to provide mechanisms through which the creditors of the debtor can maximize the recovery of amounts due to them, either by rehabilitating the business activity of the debtor, or by

sale of the debtor's assets. The rights of the creditors to recover amounts due to them must be superior to, not equal to, the rights of the debtor that incurred but could not meet those commitments, and to the rights of the owners of the debtor**.**

Impact of the Amendments Proposed by the MoJ Working Group on this Issue.

The proposed amendments, if enacted, would allow all creditors to vote on a rehabilitation plan, rather than just the secured creditors. The proposed amendments do not allow the creditors to vote by rank or class; as a result, a fully secured bank with more than 50% of the total claims will still be able to impose a plan on the unsecured creditors in a manner which damages their prospects of recovery. The treatment of creditors with very different legal rights as a single group is inconsistent with emerging best practices, and is not addressed in the proposed amendments. Creditors with different legal rights, whose rights are proposed to be affected under a rehabilitation plan, should be able to vote on the plan as separate groups. Only creditors with identical legal rights should be grouped together.

One of the proposed amendments appears to allow the imposition of a majority decision on a dissenting minority; however there is still proposed language that refers to a dissenting creditor's claim to be effectively "bought out" by the other creditors. These appear to be contradictory approaches; the first approach, namely the imposition of the decision by a majority on a minority in a group of creditors with similar legal rights is critical to the development of equitable rehabilitation plans.

The proposed amendments do not include the requirement that as a matter of basic fairness, any plan must offer at least as high a recovery on a creditor's claim as that creditor or class of creditor could expect to receive if the assets of the debtor were simply sold. This is a basic safeguard for minority or out-voted creditors found in international insolvency best practice.

LACK OF CLARITY ON THE POWERS AND DUTIES OF THE TRUSTEE AND DEBTOR

The following paragraphs in Article 26 of the Law (in relevant part) set out the rights and obligations of the trustee:

2. Rights and obligations of the Trustee:

a. To assume control over management and representation of the company during the term of its authority;

* * *

f. To keep the trusted property and to protect it from damage and destruction;

There are several problematic issues which arise from these sub-paragraphs:

- The degree or type of "control" that the trustee exercises over the management of the company is not specified. Once an insolvency proceeding has been opened, the "management of the company," should have no function other than as agent for the trustee to help implement the strategy of the trustee and the creditors to maximize the value of the debtor's assets. In more direct terms: *management now works for the trustee*. The current language of the Law implies that the management of the debtor has some other independent capacity with regard to the debtor's assets. This distributed authority causes confusion and results in inefficiencies in administration.

- In order to "keep the trusted property," as is required under the Law, the IOH must maintain all aspects of security and access to the trusted property. The trustee has the obligation to ensure that all of the debtor's assets are secure, including the banking and accounting records. Access to the computer system must be strictly controlled by the IOH if it is to ensure that the information needed to properly evaluate the assets is protected.

- Crucially, in order to "protect the [trusted property] from damage," the IOH must have the explicit responsibility to protect the net value[32] of all the "trusted property," not simply the physical protection of tangible assets. This encompasses the protection against an unwarranted *drop in value* of the asset, not merely from physical damage and theft. The IOH has an obligation to protect and maximize the net value of the intangible and perishable assets of the debtor in exactly the same way that it has the obligation to protect the debtor's physical assets. At the very least, this requires the IOH to develop an effective strategy to collect the accounts receivable of the debtor. It may also require the timely sale of perishable and time dated assets, a strategy to protect value that is not contemplated in the present law.

  The IOH cannot protect the net value of the assets for the benefit of the creditors unless it has:

  - Complete legal control of all the "trusted property," including the intangible assets such as accounts receivable, customer lists, license agreements, leases, drawings and designs, patents and trademarks, and a host of other types of assets**.** This also includes control of the documentary evidence which establishes or evidences these rights.

  - Complete and independent authority over the decisions of which expenses are to be incurred after the opening of a proceeding. The net value of the trusted property is the key concern of the IOH; it must take whatever actions necessary to preserve the value of assets available to settle the claims of the pre-insolvency creditors after the claims of the new creditors of the second rank have been settled. In practice, this means that the trustee must have the power to terminate employment contracts, including those of the managers; terminate unfavorable contracts and leases; and the power to continue to fulfill existing contracts or take on new contracts only when those contracts are likely to maintain or increase the net value of the trusted property. This is an extremely complex task, and it requires careful analysis on a contract-by-contract basis, taking into account the assets already on hand to fulfill the contract (raw materials, drawings, etc.) compared to the cost (and availability) of the labor to complete the project and of the materials required to be purchased. Because of the limited options available to an IOH after a proceeding has been opened, the earlier concepts of cost and of "normal" sales price or "market value" that applied when the debtor was operating its business activity are irrelevant. The trustee will inevitably have a different perspective than the former management, and must be in a position to assert its view if the interests of the creditors are to be "protected from damage." This contrasts with the present Law which allows that, during the period that the trustee is appointed, the debtor is able to continue its operations as it did before the proceeding is opened, except now under the "supervision" of the trustee, free from any of the pressure to pay interest to its banks or otherwise service its pre-insolvency debts. The debtor's continued involvement in the operation of the business is made explicit in Articles 21(2)(a) and 21(2)(f) which state:

    From the moment the court rules on the opening of an insolvency proceeding:

    > *(a) The debtor is not allowed to enter into any deals or terminate any existing deals without the trustee's consent; in case of the absence of trustee's consent – without the court's consent…*
    >
    > * * *
    >
    > *(f) For the purpose of uninterrupted operation, the company is entitled to assume new contractual obligations, upon the trustee's consent, or in case of absence of trustee's consent – upon the court's consent.*

[32] The "net" value used herein refers generally to the value net of expenses related to the preservation of the asset. For example, if storage and insurance costs begin to exceed the possible sale value of the asset, there is no economic benefit to be gained by further holding the asset. Likewise, perishable assets lose value quickly and must be sold almost immediately to obtain any value from them at all.

> The Law is silent of what might constitute "uninterrupted operation," and much more importantly, fails to define the purpose of the "uninterrupted operation." The ability of the debtor to continue to carry on "uninterrupted operation" with minimal supervision, and using assets which the NBE as trustee has an obligation to protect from damage, raises fundamental issues regarding the role of the trustee.

The trustee must always be conscious that the interests of the debtor differ from those of the creditors, and the debtor cannot be expected to take into account the interests of its creditors as its primary concern.

The present Law embodies the concept that the debtor, despite having no remaining financial interest in the business, should nonetheless retain many of the management powers it had prior to the opening of the insolvency proceeding notwithstanding the authority of the IOH. This is a flaw that results in many of the problems that manifest themselves in inefficient management of the insolvency process.

Recommendation: Amendments should be made to the Law which make explicit that the IOH has the sole and exclusive responsibility for protecting the net value of the trusted property, and that it has the authority to take all required actions without the interference of the debtor's management or owners. Because the present Law appears to have been conceived from a perspective reflecting more of the debtor's interests rather than the creditors, amendments which clarify the responsibility of the IOH will require numerous changes throughout. Further, wherever the IOH lacks specialized expertise to perform a specific duty, such as the requirement to collect amounts due to the debtor from third parties, the IOH should have the specific authority to engage the expertise needed.

Impact of the Amendments Proposed by the MoJ Working Group on this Issue:

The proposed amendments, as drafted, would authorize the debtor company, with agreement of the trustee (or if the trustee disagrees, in agreement with the court), to pay utility bills to ensure the "continuity of business operations." This proposal would appear to authorize the payment of a particular type of pre-insolvency unsecured claim, potentially to the detriment of all other creditors. Whether or not the other creditors are indeed damaged by such a payment depends on whether the net value of the "trusted property" has been increased or decreased by such a payment. "Ensuring the continuity of business operations" needs to be carefully qualified and defined in the proposed amendments; there is no point "continuing the business" even temporarily, on any other basis than the preservation of net value.

It would be preferable to provide a separate article that requires the public utilities to continue to provide basic services to the trustee after the opening of the proceeding, notwithstanding that the utilities may have unpaid amounts due from the insolvent debtor. This provision should not extend to private suppliers.

It is essential that the trustee has the explicit authority to sell perishable and time-dated assets as required to protect their value. It often needs to do this long before the creditors meeting, or there is any decision on whether a rehabilitation plan or a bankruptcy proceeding is the next step.

PRE-INSOLVENCY CREDITOR PRIORITIES ARE NOT SUFFICIENTLY PRESERVED IN INSOLVENCY

The important principle of determining creditor priorities on the basis of "first-in-time to register" is almost altogether set aside once an insolvency proceeding is opened. This is in sharp contrast to international best practice where pre-insolvency creditor rankings are preserved to the greatest extent possible. This significant flaw has the potential to affect the availability and cost of secured lending to all borrowers.

The Law currently interferes with the "first-in-time" principle in the following ways:

- Article 40(1)(d) classifies all secured creditors as being in the fourth rank of creditors, regardless of the legal priority each enjoyed on any collateral of the debtor before the opening of proceedings. This "pooling" of priorities produces anomalous results when the assets of the debtor are sold as a single complex; if the price achieved on sale is not adequate to settle the claims of all secured creditors, the proceeds are distributed proportionately amongst all creditors of this rank, regardless of any priority one secured

creditor enjoyed over another before insolvency. This setting aside of the first-in-time principle of establishing priority prejudices the senior secured creditors in favor of the more junior charge and lien holders, including, notably, the RS.

- Article 40(1)(g) defines the seventh and last rank of creditors as being those creditors which did not file their claims within the specified deadline. This apparently applies equally to secured creditors, and leads to the possibility that a secured lender which has registered its claim first against the debtor's assets prior to insolvency is denied its claim to be a secured creditor altogether. This poses a serious risk to the effective value of the collateral pledged to a secured creditor.

- The team was advised that if the assets of the debtor are sold as a single complex, and the assets include both encumbered (charged) assets and unencumbered assets, that the entire proceeds of sale are distributed proportionately amongst the secured creditors. There are no legal grounds for this practice; it clearly prejudices the unsecured creditors and improperly benefits the secured creditors.

- The G4G team was advised of at least one instance in which the RS was successful in its claim to the court that the tax indebtedness of the debtor which arose prior to the opening of the insolvency proceeding should be treated as creditor of the second rank (i.e. a "new creditor") on the basis that the tax liability had only been "revealed" at the date of the audit. The RS in this instance is alleged to have submitted its claim well after the 20 day deadline for the submission of claims. But instead of being ranked in the fourth or fifth rank, or even seventh rank of creditors, the RS was apparently successful in establishing itself in the second rank, ahead of the secured creditors who had registered their charges in the appropriate registry long before the time when the tax liability arose. Where such a situation is possible, it is very difficult for a lender to determine the value of the collateral it holds. This also prejudices all ranks of creditors below the second rank.

Because of the distinct legal rights created by the laws governing mortgages and pledges (i.e. secured creditors), this category of creditor may be in a substantially different legal position in an insolvency proceeding when compared to more junior creditors. To reflect this difference, many modern insolvency laws allow the mortgage holders to play only a minor role in insolvency proceedings as their position is already protected by their secured status with rights in the collateralized property. In these jurisdictions, the secured creditors are restrained from exercising their "normal" legal rights on the condition that the unsecured creditors, through the IOH, ensure that the value of their pledged collateral is not adversely affected by the imposition of the general stay. This usually requires the IOH pay the interest charges of the secured creditor, pledge additional collateral to it, or both, in order to maintain the value of the collateral relative to the size of the claim of the secured creditor. This has the effect of allowing the IOH time to develop a strategy to maximize value, while not prejudicing the secured creditors. These same provisions also typically prevent the secured creditors from claiming penalty interest and other charges that arise as a direct result of the opening of the proceeding.

This is not the case in Georgia, where the pool of secured creditors in fourth rank is below the creditors whose claims arose after the court has made a decision on opening an insolvency proceeding. This ranking has the potential to substantially diminish the net value of the collateral pledged to the secured creditors as the claims of the "new creditors" accumulate. This risk is particularly acute where the Law offers no guidance on the justification for continuing the business activity of the debtor. This practice contravenes emerging international best practice.

Recommendation: The forthcoming amendments to the Law should consider alternative ways of protecting the net value of the claims of secured creditors in a way that is likely to pose least damage to the interests of the unsecured creditors. At the very least, the Law should be amended to ensure that the "first-in-time to register" principle for establishing priority is observed after an insolvency proceeding is opened. Further, validly registered secured creditors could be recognized due to their proper public registration and not be altogether denied or considered a late claim.

Impact of the Amendments Proposed by the MoJ Working Group on this Issue:

There are no proposed amendments which address this issue.

INCONSISTENCIES IN REHABILITATION PLAN GOVERNING ARTICLES

Modern insolvency laws include provisions for rehabilitation (or reorganization) in the recognition that if a debtor's business can be rehabilitated, the value of the debtor's assets may be greater than if they are sold piecemeal or at auction, as well as having wider economic benefits. As stated elsewhere, a typical insolvency law treats rehabilitation as a strategy to achieve maximum value for the creditors whose claims have not been paid, and not an end in itself.

The purpose of rehabilitation is usually to maximize the "going concern" value of the business. The focus is on the business activity, not on the legal form through which this activity has been conducted. The management or founder of the debtor are the parties which in the past have been unable to operate the debtor's business in a manner which would allow the debtor to settle its obligations; to believe that they are the only parties that can rehabilitate the insolvent business requires an assumption that the people responsible for the management of the business as it declined are the people who can most efficiently use those assets in the future.

The articles in the Law on Insolvency Proceedings on rehabilitation plans have a number of features which limit the attractiveness of this strategy as a way to maximize value. These include:

- The requirement that the claims of all creditors be fully settled (i.e. paid 100%) is an unrealistic requirement for a debtor which has operated unprofitably in the past (hence the insolvency proceeding). The primary way for a debtor to comply with this requirement is to promise to pay its creditors over a greatly extended period in the future. The difficulty with this approach is that it is impossible to predict the future with any accuracy more than a year or two ahead and the creditors have no way of being able to calculate the value of such a promise. The present value of a promise to pay in, say, eight years is close to zero.

- The unsecured creditors, in particular, have no way to know if the plan presented to them is likely to result in a greater chance of a recovery on their claims than any other rehabilitation plan, or from the sale of the debtor's assets. This is important: if the purpose of a plan is to maximize the likely recovery by the creditors, then they will need to know what the options, including outright sale of the debtor's assets, are likely to produce. For this reason, a rudimentary liquidation analysis should be required, and included in information given to the creditors prior to their voting on the proposed plan. It should be a basic requirement that a rehabilitation plan cannot be approved by the court unless it is designed in such a way that all classes (ranks) of creditors recovery *at least as much* on their claims under a plan as they would be if the assets were sold. Promising full payment far in the future is not a realistic measure of the likelihood of recovery for this purpose.

- Currently under the Law, unsecured creditors are denied the opportunity to vote on whether or not they accept the rehabilitation plan presented to them. This is completely contrary to the concept that where their rights are being affected, the creditors should be able to express their opinion through a vote. This is a clear contravention of emerging international best practices whereby unsecured creditors have a voice on the acceptance of a rehabilitation plan.

- Article 45(6) requires the unanimous consent of all creditors in a class or ranking to the differential treatment of one or more of the creditors in that rank. This inhibits the creation of rehabilitation plans in which creditors that have the same legal status, but who have different interests, can be separated into sub-classes based on interests. For example, some unsecured creditors may be prepared to take a deep discount in order to receive a small recovery early (and to thereby enable a claim for recovery of taxes from the RS, for example), while others may be content to accept a higher recovery spread over a number of payments. Sub-groups are typically created to appeal to as many creditors as possible, and so to gather enough positive votes to approve the plan. In Georgia, unsecured creditors are in the anomalous position of being required to give unanimous consent to a proposal that they would then be unable to vote on.

- There is no provision in the rehabilitation sections of the Law to allow the decision of the majority, however defined, to be binding on the dissenting minority. Requiring unanimous consent creates a situation where, at least amongst the creditors who are entitled to vote,

an individual creditor could blackmail the other creditors and so achieve a higher (and unfair) recovery than others in its ranking. Alternatively, it increases the chances that the required approval cannot be obtained at all. The decision of the majority of a class of creditors with equal legal rights should be binding on a dissenting minority for a rehabilitation plan to be workable in practice. Otherwise, a single hold-out creditor can block a feasible and fair rehabilitation plan.

- The overly large number of ranks or classes of creditors inhibits the attraction of almost all rehabilitation plans based on payment of claims from future earnings, because all senior ranks must be settled before the junior unsecured creditors recover any part of their claims. As a consequence, such junior creditors, if given a vote, may well simply opt for a sale of the assets of the debtor, as this may offer an earlier and more certain recovery at least a portion of the amounts due to them. "Best practice" encourages the use of a minimum number of classes of creditors.
- In particular, treating the amount due to the RS as a general unsecured debt, rather than a secured or senior unsecured debt, will substantially enhance the likelihood that the junior unsecured creditors will recover at least a portion of amounts due to them. In addition, this will realign the incentives involved in the decision to accept or reject a rehabilitation plan. Where the RS holds an overwhelmingly large claim (as is the case historically in Georgia as evidenced from analysis of insolvency statistics), there would be little reason for the RS to vote to accept the delays in receiving their payment over time under a rehabilitation plan. Rather, the incentive that such a high priority status provides is to opt for bankruptcy with the more immediate payment that this speedy sale of assets brings. Under such circumstances, it is unlikely many re-organizations would succeed.[33]
- Article 45(4) states that the "rehabilitation plan shall be submitted in a written form and should cover all important issues related to the financial hardship of a debtor, with the consideration that after solving these problems the debtor overcomes insolvency or anticipated insolvency." It would appear from this and other provisions in the law regarding rehabilitation that the debtor is not only given "equal" rights to the creditors, but in fact superior rights. The provision's aim is to maintain the debtor, primarily at the expense of the claims of the unsecured creditors. This is not consistent with the objective of insolvency laws in other jurisdictions or international best practice.

Recommendation: The rehabilitation articles of the Law should be substantially re-formulated in such a way as to require the preparation of a realistic plan, and to ensure that each rank of creditors have enough information to be able to assess whether the offered plan is likely to result in a higher recovery on their claims than bankruptcy.

It is to be noted that there are many types of plans that could benefit the creditors, not all of which involve the debtor. One such example, which could be particularly useful in Georgia where assets of a bankrupt debtor are required to be sold at auction by the NBE, is a "self-liquidating" reorganization plan. Such a self-liquidating allows the sale of debtor's assets *over an extended period of time* by design. As a validly-approved reorganization plan, it would not be subject to the rules governing NBE auctions.

Appendix F contains Article 128 from the Serbian Insolvency Law, which sets out the components that can be included in a rehabilitation plan in that jurisdiction. Note that a plan can contain more than one of the options set out in the Article.

Impact of the Amendments Proposed by the MoJ Working Group on this Issue:

Several of the proposed amendments address certain concerns raised in this section. If the proposals are enacted, the Rehabilitation Manager will have a requirement to keep the creditors informed as to the progress of the implementation of the plan. One of the proposals appears to allow a decision by the approval of a plan by a majority of creditors to be binding on a dissenting minority. However, when a change is proposed to the original plan, 100% approval of the creditors is still required.

[33] Emerging trends in international insolvency reveal that "Crown Preference" (special high priority for government claims) within legislated bankruptcy distribution priorities is in increasing disfavor.

Further, the proposed amendments do not include a requirement that classes of creditors whose rights are affected differently by the plan should vote separately, or that a majority vote by each class is required if the plan is to be approved.

There is nothing in the proposals that requires that all classes of creditors realize at least as great a recovery on amounts due to them under a rehabilitation plan as they could expect to recover if the assets are sold in bankruptcy. This is a vital safeguard that should be contained in the amended Law.

CUMBERSOME AND UNWIELDY ASPECTS OF THE LAW

In our interviews, we encountered a large number of concerns over the excessive amount of time an insolvency proceeding took to complete. Of the many possible causes, we noted the following:

FACILITATION COUNCIL

The Facilitation Council is widely viewed as an unaccountable body, with inappropriate powers whose functioning slows down the process.

The Facilitation Council has the power to determine whether the debtor should proceed to a rehabilitation plan or go to a bankruptcy process. The information which must be made available to the Council to assist it to make this important decision is not specified in the Law; given the limited information required to be given to the creditors meeting it is unlikely that the Facilitation Council has adequate information available to it in all circumstances to decide on rehabilitation or bankruptcy. Its decisions are not subject to review by the creditors or by the court, and the Council is wholly unaccountable.

The G4G team was advised that the members of the Facilitation Council are not entitled to a fee for their work. This is not an arrangement that is likely to encourage competent people to agree to serve as Council members.

Recommendation: The Facilitation Council should be abolished and the powers and duties of the trustee and creditors expanded accordingly. The creditors themselves should be able to choose between the possibility of rehabilitation or bankruptcy at the first creditors meeting. To allow the creditors to make an informed choice, the information that the trustee must provide to the creditors' meeting needs to be expanded to include at least (i) an estimate of what the creditors might expect to receive in a bankruptcy proceedings; (ii) whether there is a possibility that a rehabilitation plan may produce a greater recovery; and (iii) the basic components of such a plan. Because at present the creditors are ranked into a large number of rankings, these estimates should specify the expected recovery by each rank of creditor.

Impact of the Amendments Proposed by the MoJ Working Group on this Issue:

The proposed amendments require that the court approve the decisions of the Facilitation Council, which makes the Council much more accountable. We believe this will result in further delay. The proposed amendments do not contemplate the elimination of the Facilitation Council as one of the parties to an insolvency proceeding.

CREDITORS MEETING FUNCTIONING

The requirement that the creditors' meeting, held in court and led by the judge, review each and every submitted claim individually appears unnecessarily cumbersome. Consideration should be given to establishing a process in which the trustee examines the claims received, compares them to the debtor's books and records, and where they correspond, simply make a list of such claims for approval by the court. In this case, only the *disputed* claims remain to be resolved, normally by a court action initiated by the creditor whose claim has been challenged by the trustee, and defended by the trustee who is disputing it. It is not necessary, or often even appropriate, for each and every creditor to express its views regarding the claims of other creditors. Where the trustee recommends acceptance of a claim but it is disputed by another creditor, then that creditor should bear the cost of initiating and pursuing an action to have the claim denied.

Another method used to accelerate the proceedings is to separate the process of approving claims from the other "operational" business of the creditors, such as directing the trustee,

appointing a Creditors' Committee, and deciding on whether a rehabilitation plan or sale of the assets is in their collective interests.

Impact of the Amendments Proposed by the MoJ Working Group on this Issue:

None of the proposed amendments address this concern.

CREDITORS' COMMITTEE ESTABLISHMENT

Especially in large insolvencies, it is very useful for the trustee and the court to have the advice and input of a Creditors' Committee. Such a committee can advise the trustee on routine or minor issues that should not need the input of a creditors meeting, and which should not necessarily require the approval of the court. Such a committee also oversees the activities of the IOH, and can represent the interests of the creditors before the courts in any dispute with the trustee.

Article 28 of the Law contemplates the election of a Creditors' Committee. However, the Law is silent on the powers, remuneration or composition of such a committee, leaving that to the Creditors Meeting.

Recommendation: The election of a Creditors' Committee should be required in all large insolvency proceedings, however defined. The Committee should include representatives of the secured creditors, unsecured creditors with large claims, unsecured creditors with small claims, and possibly a representative of the unpaid employees, and contain an odd number of representatives. The Committee should make decisions based on a majority vote, where each member has one vote. The basis for remuneration of the Committee members should be set out in the Law, and not left to the creditors to determine. Typically members of the Creditors' Committee are paid a modest sum per meeting to recognize their efforts on behalf of the body of creditors.

Impact of the Amendments Proposed by the MoJ Working Group on this Issue:

None of the proposed amendments address this concern.

RELATIONSHIP BETWEEN THE BANKRUPTCY MANAGER, THE REHABILITATION MANAGER AND CREDITORS

The Georgian Law distributes the roles of those governing the insolvency process among three separate functionaries that take responsibility at differing points in a given insolvency case. A basic understanding of the roles is important to describing the systemic weakness that the current landscape of responsibilities that the Law presents. The three roles of IOH's created by the Law are as follows:

- Trustee

  Appointed from the date of the decision of the court to open an insolvency proceeding. Since 2011, the NBE is appointed to fill this role, as mandated by Article 26(1) of the Law. The powers and duties of the trustee are set out in the Law in only very general terms. The role of the trustee ceases when either the Bankruptcy Manager or the Rehabilitation Manager is appointed by the meeting of creditors.

- Bankruptcy Manager

  Appointed by the meeting of creditors. If the meeting of creditors does not appoint the Bankruptcy Manager, or if the meeting fails to nominate a Bankruptcy Manager, then the court will appoint the NBE as the Bankruptcy Manager. Article 37(4) of the Law stipulates that the Bankruptcy Manager and creditors are to conclude an agreement which determines the scope of the authority, fees and liability of the Bankruptcy Manager.

- Rehabilitation Manager

  Article 44(2) of the Law states: "The creditors appoint the Rehabilitation Manager and determine the timeline for working out the draft rehabilitation plan within 3 days after publishing the court ruling on rehabilitation." The court ruling referred to above is the ruling approving the decision made by the Facilitation Council (Article 33(7)). The Rehabilitation Manager is required to be independent, unbiased, and [a party] who does not "conduct the same or similar activity as the debtor" (article 44(3). The duties of the Rehabilitation Manager are agreed between the manager and the creditors.

The NBE currently is acting as trustee in 18 proceedings and as Bankruptcy Manager in 34 proceedings. Private individuals or legal entities are acting as Bankruptcy Manager in only 3 proceedings. There are currently 8 open rehabilitation cases at Tbilisi City Court.

Prior to 2011, individuals and legal entities in the private sector filled all the three IOH roles set out in the Law. The team was advised that these private individuals and firms were not always perceived to act in a consistent professional manner, and that many of these perceived abuses could be avoided by having the NBE act as trustee in all proceedings.

The team discussed with one Rehabilitation Manager the difficulty he had in reaching a binding agreement with the creditors, as the creditors as group or class are not a legal entity, and at a more practical level, he could not find anyone who was prepared to sign an agreement with the manager on behalf of the creditors. The same consideration applies in the case of a Bankruptcy Manager; he has no proper counterparty. The NBE apparently avoids this issue by not concluding an agreement with the creditors; rather it relies on the few articles in the Law that describe the duties of the Bankruptcy Manager and on the fee entitlement contained in the Decree 144 of the Minister of Justice.

Recommendation: It would be preferable to have the Law or a supporting decree set out the duties of the Bankruptcy Manager and Rehabilitation Manager in considerably more detail than in the present Law. In particular, the basis of the fee award should be set out in the Law or supporting decrees. The question of an appropriate fee is of course related to the qualifications that a manager needs to have to fill these important positions.

Impact of the Amendments Proposed by the MoJ Working Group on this Issue:

The proposed amendments include a requirement that a private sector Bankruptcy Manager or Rehabilitation Manager has unlimited liability to the creditors for any damage the manager's actions may cause. This amendment is not proposed to extend to the NBE or its employees, either in its capacity as trustee or as Bankruptcy Manager.

THE NATIONAL BUREAU OF ENFORCEMENT AS INSOLVENCY OFFICE HOLDER

Two main concerns dominated those voiced by people in the private sector who deal with insolvency matters regarding the role of the NBE. These are:

- The NBE is not accountable to the parties involved in the proceeding, and it cannot be replaced once appointed. The Law allows that complaints can be made against the individual within the NBE who has been assigned responsibility for carrying out the duties of an IOH in an insolvency proceeding, but the sole remedy is for that individual to be replaced with another NBE employee, which is not an entirely adequate remedy. This observation is consistent with the EBRD assessment that there is no system for training or qualifying people who work as employees of the NBE in the role of trustees and bankruptcy managers, nor is there a Code of Ethics for these employees that relates specifically to administering insolvencies, nor is there any effective system of oversight of their actions.

- The fees charged by the NBE for its services as trustee and/or Bankruptcy Manager have been changed frequently, but at present is 7% of the realized value of the assets (subject to a minimum fee) for acting as trustee, and a similar amount for acting as Bankruptcy Manager. There is no maximum to the fee due to the NBE for either role. This fee structure does not recognize the amount of effort required to achieve a certain result, or that there are economies of scale which apply to selling many types of assets; it does not usually take twice as much effort to sell a building valued at 10 million GEL as it does to sell a building valued at 5 million GEL. In the private sector, this is often taken into account by charges of lawyers and accountants being based on the amount of time spent on a task, not on a flat percentage.

There is another basic concern, namely that there is such a lack of clarity in the Law which defines the roles of the trustee and Bankruptcy Manager that the employees of the NBE face considerable uncertainty in interpreting their responsibilities. As a result of this lack of clarity, the NBE is placed in a difficult role, especially in its dealing with the management of the debtor. Without specialized training or resources specifically tailored to the complexities of administration of insolvency proceedings the difficulty is doubled. Certainly the staff of the NBE can be

equipped and trained to better perform this role, however, we see no compelling reason that the NBE need replace the private sector. We note that the private sector held appointments to the offices of trustee and Bankruptcy Manager prior to 2011.

Fees were also a concern. Setting a fair level of remuneration for the trustee and the Bankruptcy Manager is a difficult task anywhere. All proceedings require a great deal of work in the early stages, and reflect work that must be done regardless of the size of the debtor. The outcome is that in proceedings with only a few assets, all or most of the value of the assets will go to pay the trustee's fees. However, not all larger value assets require proportionately as much effort to control and manage, and it would be appropriate to have a fee scale that reflects these "economies of scale." Ideally, the fee should be set using a combination of the effort required to fulfill the duties of that particular office, plus an additional reward for exceptional results. In Georgia, where at present assets in a bankruptcy proceeding must be auctioned, there would appear to be little opportunity for a "performance bonus." The fee scale should be redesigned in such a way that it does not result in a return to the NBE that is significantly more than a private professional would earn for the same job, if he based his fee claim on time worked. In particular, it is unclear why the fee for acting as the Bankruptcy Manager is identical to the fee for acting as trustee, since the work of identifying the assets and verifying the claims has, by that point in time, already been performed by the trustee, and the auction division of the NBE will sell the assets (for an additional 1% fee) once a bankruptcy proceeding has been opened.

Our findings are consistent with those of the extensive 2014 EBRD assessment[34] in which it reports the results of a survey requesting information on IOHs in 27 jurisdictions.[35] The findings of the EBRD survey were reflected in comments made to us during our interviews with people in Georgia familiar with insolvency proceedings. The EBRD used the following benchmarks in its assessment of the status of IOH:

- Licensing and registration;
- Regulation, supervision and discipline;
- Qualification and training;
- Appointment system;
- Work standards and ethics;
- Legal powers and duties;
- Remuneration.

The EBRD assessed Georgia to be deficient in all these categories, with the exception of its Appointment System.[36]

We also note that Georgia is the only jurisdiction surveyed in which the IOH is a state entity. It is instructive to examine the different sorts of frameworks other developing economies have used to address the issues surrounding the development of a profession of IOH, without resorting to use of a state entity. These are outlined in the EBRD survey.

Recommendation: We recommend that the Law be amended in such a way that it clarifies the NBE duties with more specificity. Also, that the employees of the NBE receive additional specialized training in the practical role and responsibilities of a trustee and bankruptcy manager. It is also essential that the NBE, as trustee, be required to document that is has taken all actions necessary to fulfill its mandate to protect the "trusted property from damage," and that is be subject to the same requirements that apply to a private IOHs, including those governing redress in situations where it has damaged the interests of the creditors. In addition, the fee scale should also be redesigned so that it does not result in a return to the NBE that is significantly more than a private professional would earn for the same job.

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[34] *Assessment of Insolvency Office Holders:* Review of the Profession in the EBRD Region, European Bank for Reconstruction and Development, 2014, http://assessment.ebrd.com/insolvency-office-holders/2014/report.html. We note the use of the word "Profession" in the title of the assessment.

[35] Ibid, Section 2, Overview of EBRD insolvency office holder assessment results, http://assessment.ebrd.com/insolvency-office-holders/2014/report/section-2-overview-of-ebrd-insolvency-office-holder-assessment-results.html

[36] Ibid, Country Profile: Georgia, http://assessment.ebrd.com/insolvency-office-holders/2014/country-profiles/georgia.html

Impact of the Amendments Proposed by the MoJ Working Group on this Issue:

There are no proposed amendments which address the required qualifications and standards of professional performance required by parties that carry out any of the IOH offices.

OBSERVATIONS OF INCONSISTENCIES IN THE LAW

The paragraphs below contain a partial list of inconsistencies identified during the team's review. It is not meant to be a comprehensive list.

- The "trusted property" consists of all of the property of the debtor as of the date that the proceeding is opened. Article 38 requires that the NBE sell the trusted property by auction. However, Article 21(2)(e) refers to the "uninterrupted operations" of the debtor, which could well include the sale of the inventory element of "trusted property" in the period between the date the proceeding is opened and when the creditors decide on rehabilitation or bankruptcy. The two concepts are clearly inconsistent; the Law should explicitly allow methods of sale of the assets of the debtor by other means than auction.

- All creditors, including unsecured creditors, vote in Creditors Meetings, on the basis of 1 GEL = 1 vote. The creditors, including the unsecured creditors, appoint the Rehabilitation Manager. However, after that, secured creditors must approve a rehabilitation plan unanimously while the unsecured creditors are not given the opportunity to vote at all. All creditors whose interests are affected by a rehabilitation plan should be entitled to vote on the plan. Where the rights and interests of different classes of creditors are treated differently in the rehabilitation plan, each class or rank should vote separately to determine whether that class is prepared to accept the manner in which the claims of the creditors of that class are proposed to be resolved by the rehabilitation plan.

- Article 44(6) states that the unanimous approval of the secured creditors is needed if the rehabilitation plan calls for an increase in the capital base of the debtor. Unsecured creditors are not consulted. All references in the present Law to the requirement for the unanimous approval of secured creditors should be removed and replaced by rules which require the approval of each class of creditor whose rights are affected by the proposed action. Majority approval, rather than unanimous approval, should be the standard of acceptance required.
- Article 37(6) states that if, upon application, the court removes a Bankruptcy Manager appointed by the creditors, it is required to appoint the NBE as Bankruptcy Manager in the place of the dismissed Bankruptcy Manager. Under this provision, creditors do not have an opportunity to appoint another natural person or firm from the private sector, nor do they have the opportunity to replace the NBE with a Bankruptcy Manager of their choice. There is nothing in the Law which determines how the fee due to the Bankruptcy Manager should be apportioned between the private sector Manager and the NBE, when the NBE is appointed sometime after private sector Manager has been acting.

- Article 39 is entitled "The Specific Authority of the Secured Creditors." These authorities include taking "the decision unanimously on arising new debts of the debtor." Since taking on new debt (which are classed as the second rank of creditors) will affect <u>all</u> ranks of creditors junior to the second rank, it is not clear why the secured creditors should be the only rank qualified to approve the creation of "new creditors." It is the lower ranks of creditors, not the secured creditors, whose interests are most put at risk by the debtor taking on "new debt." Nor is it realistic to require unanimous approval; this gives any individual creditor unwarranted veto power. This article should be deleted from the law, in order to treat all creditors fairly, according to their legal rights.
- Article 50(2): "The Rehabilitation Manager shall be authorized to submit full information on the progress of the rehabilitation plan to the <u>secured</u> creditors within the timeline defined by the rehabilitation plan." Not only are the unsecured creditors denied the opportunity to vote, they are not entitled to be informed by the Rehabilitation Manager of the progress of the plan. The Rehabilitation Manager should have the obligation to inform all creditors on a regular basis as to the progress it, or the debtor, has made in implementing the rehabilitation plan.

- The effective extension of the collateral held by secured creditors to unencumbered assets when the assets of the debtor are sold at the first auction is not supported by any law, but is the practice. The Law should be amended so the purchase proceeds are allocated between the secured creditors and the unsecured creditors, on the basis of the valuation of the individual components of the assets offered as a "complex unit." This of course requires that the intangible assets of the debtor are properly valued.

- A rehabilitation plan can be converted to a bankruptcy proceeding, but the Law does not contain provisions allowing the conversion of a bankruptcy proceeding to a rehabilitation plan. Notwithstanding this omission in the Law, we understand that the courts are willing to approve such a conversion. The Law should be amended to provide a specific legal basis for such a conversion.

OBSERVATIONS OF GAPS IN THE LAW

Because the law contains a small percentage of the number of provisions that would typically be found in other modern insolvency laws, it is understandable that it contains many gaps and ambiguities, the most salient of which include:

- There is nothing in the Law that specifies that the Law on Insolvency Proceedings is a "*Lex Specialis,*"[37] which would ensure that the provisions of this Law prevail over the provisions of other laws and decrees when there is a conflict. This is particularly important when the trustee, Bankruptcy Manager or Rehabilitation Manager applies to the various registries to remove charges and liens to allow the debtor's assets to be used, or in the case of a rehabilitation plan, sold.

- The Law should include a provision that requires that the public utilities continue to provide water, power and gas to the trustee if this is necessary to preserve the value of the "trusted property," notwithstanding the fact that the debtor may have a pre-insolvency debt owing to those utilities. This provision should not apply to private sector creditors who decline to sell further material to the trustee.

- Similarly, the law should provide that a landlord should not be able to use the excuse of the opening of a proceeding as grounds to evict the tenant debtor. The IOH also should have the power to abandon leases not needed to protect the value of the assets, in which case the landlord would have an unsecured claim for damages in the proceeding.

- There are no provisions setting rules for goods in transit at the date a proceeding is opened.

- There are no provisions which explicitly set out the powers of the trustee to deal with perishables and time-dated assets included in the "trusted property."

- There are no provisions in the law which set out the required experience and qualifications of individuals who carry out the duties of trustee, nor any adequate manner in which these people, or the NBE, can be held accountable to the creditors for any damage its actions have caused the creditors.

- The team was unable to ascertain if, in the situation where a bank holds a mortgage charge on the debtor's property and upon default the debtor transfers title to the property to the bank, the bank is obliged to return to the debtor, or to the trustee if the debtor has become insolvent, any excess in value in the transferred property over the debtor's actual indebtedness to the bank.

- The law does not contain a provision that the pre-insolvency debts of an entrepreneur/ natural person debtor are completely extinguished upon the termination of an insolvency proceeding.

[37] Derives from the Latin legal maxim "*lex specialis derogat legi generali*,"which embodies the concept that a law governing a specific subject matter takes precedent over a law that only governs general matters. Here, that in an insolvency case, the insolvency law should govern when in conflict with other non-insolvency law. *See: e.g.* www.uslegal.com http://definitions.uslegal.com/l/lex-specialis/

Impact of the Amendments Proposed by the MoJ Working Group on this Issue:

With the exception of the proposed amendment relating to utilities, discussed in an earlier section, none of these gaps are addressed by the proposed amendments.

CONCLUSIONS

NEED FOR A SUBSTANTIALLY NEW LAW

The present Georgian Law on Insolvency Proceedings departs from "best practices" in many regards. In particular, the Law does not provide reasonable mechanisms through which the creditors can maximize the recovery of amounts due to them by an insolvent debtor. Instead, it focuses strongly on the survival of the debtor, despite the fact that almost by definition, the debtor may not be the party that can use the assets of its business efficiently. This emphasis may be due to historical influences, but it is not necessarily the appropriate approach at the present stage of Georgia's economic development. This orientation of the Law permeates throughout many provisions, as well as the interpretation and application of those provisions. In addition, the Law contains fundamental flaws that do not adequately protect the rights of creditors, in terms of both preservation of pre-bankruptcy legal priority as well as an appropriate level of participation in the proceedings. Further, the roles and responsibilities of current insolvency functionaries are not optimally distributed in a manner that yields the most effective and efficient case resolution.

As noted above, the proposed amendments to the law address only some of the concerns raised in this report. However, the amendments do not adequately address the limitations imposed by having a law of so few definitive articles, nor do they address several fundamental issues including:

- Defining the purpose of the law as a mechanism to maximize recovery by pre-insolvency creditors of amounts due.
- Setting out clearly the powers and responsibilities of the IOH, and especially the trustee, to protect and conserve the net value of all asset classes.
- The training, qualification, of responsibility of parties filling any of the IOH roles

Due to the broad and encompassing nature of these deficiencies, we believe that mere amendments the existing Law are not likely to remedy the flaws and inconsistencies. The team recommends that strong consideration be given to the drafting of a new insolvency law that much more closely meets "best international practice."

NEED FOR SPECIALIZED LEGISLATION GOVERNING IOHS

The present law allows private individuals and legal entities to be appointed as Bankruptcy Managers and Rehabilitation Managers, and in all other countries included in the EBRD IOH survey private individuals can be qualified to act as trustee. Georgia is the only jurisdiction surveyed in which the trustee is a government entity. In our review, we did not encounter any compelling reason why the NBE, as a government entity, should be the sole party authorized to be appointed to as one of the three IOH roles, namely that of trustee.

Administering an insolvency case is a complex undertaking that requires specialized knowledge, skills and disciplines, and is a job that is increasingly filled by highly-trained and specialized professionals globally. As the EBRD assessments have clearly pointed out, Georgia is furthest from "best practice" in its lack of any regulatory mechanism for the development of trained, qualified, professional IOHs. The absence of such trained and qualified IOHs within the NBE severely affects its capacity to fulfill the complex roles of trustee and Bankruptcy Manager. We recommend that the Law on Insolvency Proceedings be amended, or a complementary law specific to IOHs be prepared to establish a structure which specifies the qualifications required to act as an IOH. This will include professional qualifications, usually as a lawyer or accountant or either, a licensing process, a supervision and disciplinary process, and a minimum fee structure. Supporting decrees would need to specify the Body of Knowledge all trustees must possess, a Code of Ethics, and ideally, professional standards that set out the standards that a professional IOH is expected to adhere to when acting as an IOH.

INSOLVENCY DEPARTMENT OF THE NBE AS A REGULATORY BODY

As an additional recommendation, we suggest that the MoJ consider developing a medium-term strategy under which the Insolvency Department of the NBE converts its current role of acting directly as an IOH, into that of a regulatory body which oversees the licensing and discipline of private sector IOHs. In this regard, we estimate that Georgia is likely to need less than 50 licensed IOHs in the foreseeable future.

APPENDIX A: LIST OF CORRESPONDENTS IN GEORGIA

Name	Title	Organisation
Mikheil Sarjveladze	Deputy Minister	MoJ
Irina Tsakadze	Head of the Public Division of Department of Legal Drafting	MoJ
Ioseb Baghaturia	Chairman	NBE
Papuna Papiashvili	Head of Brand and Development & Sales Stimulation Office	NBE
Natia Sakhokia	Head of Insolvency proceedings office	NBE
Lasha Kochiashvili	Judge	Tbilisi City Court
Tamar Chuniashvili	Judge	Tbilisi City Court
Nino Mumladze	Chief specialist, Office of Court Disputes	RS
Dr Jens Deppe	Team Leader	GIZ
Nona Gelashvili	Legal Expert	GIZ
David Gogichaishvili	Head of Problem Loans and Asset Management Division	TBC Bank
Vasil Titvinidze	Problem Business Assets Management Senior lawyer	TBC Bank
Dr Roin Migriauli	Chef Partner, Attorney	Migriauli & Partner
David Metskhovrishvili	Senior lawyer	Mgaloblishvili, Kipiani, Dzidziguri (MKD)
Tamta Ivanishvili	Senior Associate	BLC Law Office
Nana Amisulashvili	Partner	VBAT (Law firm)
David Gvetadze	Managing Partner	PKF Georgia LLC (Audit, tax, legal & valuation services)
Keti Kvartskhava	Partner	BLC Law Office
Gocha Svanidze	Member of Ethics Commission	Bar Association
David Glunchadze	Lawyer	Goodwill
Giorgi Chumashvili	Rehabilitation Manager	Goodwill
David Lelashvili	Director of Free University Research and Consulting Group	Free University of Tbilisi

APPENDIX B: EBRD INSOLVENCY LAW AND IOH ASSESSMENT PROJECT 2009 SUMMARY

EBRD INSOLVENCY LAW ASSESSMENT PROJECT - 2009

GEORGIA

The assessment is based on the Law on Insolvency Proceedings 2007 as amended

GENERAL INSOLVENCY LAW ASSESSMENT

The assessed compliance score for the general insolvency law assessment was 63%, indicating Low compliance.

The law in Georgia is weak and inadequate in a number of areas. The following are illustrative examples. As regards commencement there is no 'balance sheet' (liabilities in excess of assets) test for insolvency, no provision for an interim stay and no stay on actions by persons whose property is leased, hired or occupied by the insolvent debtor. The pre-bankruptcy avoidance provisions lack detail and are vague and uncertain. In addition there are no or no sufficient provisions regarding delivery up of assets of the debtor or for the provision of information concerning assets of the debtor. Reorganisation is badly dealt with. There is no requirement for adequate disclosure of material information in respect of a proposed plan of reorganisation, no minimum protective requirements for a plan, a weak plan approval process and no provision for on going finance.

IOH ASSESSMENT

The assessed compliance score for the IOH Assessment in this area was 27%, indicating Very Low compliance.

This year the assessment included a special part (part F) on the law relating to IOHs (trustees, administrators etc.). The assessment in this area was based upon the EBRD Office Holder Principles ('the principles') that were developed in 2007. It is an important area for assessment since in almost every case the respective laws of the countries that are assessed require the appointment of an office holder to administer the case. The quality of IOHs, their appointment and supervision may have a crucial impact on efficient implementation of the law. This area was therefore selected to be assessed in depth and rated separately.

The assessed compliance score for Georgia in this area was 27% indicating very low compliance. There are no qualification, licensing, regulatory, supervisory or discipline requirements or controls. There are no professional work standards and no rules of ethics. The appointment and review process is highly suspect. There is no requirement for professional indemnity insurance.

APPENDIX C: STATISTICAL INFORMATION ON ALL OPEN PROCEEDINGS PROVIDED BY THE NBE

#	Company	Date of Court Order Issuance	Comment	Value of Trusted Property (GEL)	Amount of RS secures claim	Total value of claim of secured creditors	Non-secured creditors and value of their claims	Total claims	Percent RS Claims	Stage	Bankruptcy Manager
4	JSC "Azoti"	06-06-05	Shares in LLC and Russian JSC are to be evaluated, which cannot be done.		1,329,034	1,329,034		1,329,034	100%	Bankruptcy	NBE
6	Energy XXI	10-07-08		225,982,028	37,429,675	37,429,675	188,513	37,618,188	99%	Bankruptcy	NBE
10	JSC "Saqartvelos abreshumi" / Silk of Georgia	20-07-11		1,370,000	975,848	975,848	44,828	1,020,676	96%	Bankruptcy	NBE
12	Mukhriani-98	22-12-11	2 unregistered immovable property		130,730	130,730	7,009	137,739	95%	Bankruptcy	NBE
21	JSC "Elektrotermoshedugjeba"	04-09-12	Accounts receivable, limitation periods whereof have been expired.		1,111,540	1,111,540		1,111,540	100%	Bankruptcy	NBE
25	LTD "Turbaza mtsvane kontskhi"	08-02-13	Accounts receivable could not be assessed by the Evaluation Office. Claims are worth of 29,454.29 GEL	29,454	126,623	126,623		126,623	100%	Bankruptcy	NBE
37	JSC " National Center of Oncology, named A. Gvamichava	18-06-14	Has movable property, some part whereof has been assessed at 46 630 GEL	46,630	7,189,109	7,189,109	294,377	7,483,486	96%	Bankruptcy	NBE
42	LTD "Tori"	16-12-14	Accounts receivable in amount of 6,743,141 GEL, which could not be evaluated.		132,595	132,595	11,842	144,437	92%	Trusteeship	
44	LTD Kobuleti Regional Hospital	09-01-15	111,982 GEL	111,982	1,438,991	1,438,991	126,518	1,565,509	92%	Bankruptcy	NBE
47	LTD "Keda forestry"	27-02-15	Value of movable property is 149,680 GEL. 1 tractor could not be evaluated and accounts receivable, cumulative value whereof is 9,296 GEL.	10,792	1,633	1,633		1,633	100%	Trusteeship	
48	LTD "Tsinandali" - Wine Treasure of Georgia	16-03-15	Property is not yet assessed. Balance value of movable property is 810,210 GEL, albeit the property does not exist anymore.		10,188,767	10,188,767		10,188,767	100%	Trusteeship	
51	LTD ,,Tkis Nobati''	31-03-15	Movable property - balance value 1,556 GEL.	1,556	479,140	479,140	3,030	482,170	99%	Trusteeship	
52	LTD "Jiaiji" 2007"	31-03-15	Movable property - market value 61,000 GEL	61,000	89,513	89,513		89,513	100%	Trusteeship	

53	LTD "Technoimport"	08-04-15	Property is not yet evaluated. Balance value of movable property is 25,974.60 GEL.	25,974	245,624	245,624		245,624	100%	Trusteeship	
	RS Claims More than 90% of total claims			**227,639,416**	**60,868,822**	**60,868,822**	**676,117**	**61,544,939**	**99%**		
5	LTD "gazmsheni"	05-04-07	The Price of real property and movable property is being evaluated		2,393,811	2,393,811	537,886	2,931,697	82%	Bankruptcy	NBE
9	LTD BMP Georgia	15-06-11	Market value of movable property - 448,702.50 GEL.	448,702	2,406,714	2,406,714	1,060,270	3,466,984	69%	Trusteeship	
13	LTD "Mirian Broiler Poultry Factory"	23-12-11	Accounts receivable could not be assessed by the Evaluation Office. Claims are worth of 9,400 GEL.	9,400	865,176	865,176	140,409	1,005,585	86%	Bankruptcy	NBE
23	JSC Institute of Cardiology of Mikheil Tsinamdzghvrishli	21-11-12	Owns books (around 2,000), which are being evaluated.		326,712	326,712	75,769	402,481	81%	Bankruptcy	NBE
32	LTD "New City"	09-01-14	Accounts receivable 2,732,682.49 GEL. Could not be evaluated.		6,995,847	6,995,847	1,499,342	8,495,189	82%	Bankruptcy	NBE
33	LTD "Constructing Company Avtobani"	10-01-14	Value of movable property is 700 GEL. 2 cars need to be identified.	700	199,217	199,217	102,627	301,844	66%	Bankruptcy	NBE
35	JSC "Constructing Company Tbilisi"	17-03-14	Cumulative value of real/immovable property is 312,200 GEL, but the rest of the property needs to be evaluated.	312,200	8,776,591	8,776,591	7,769,919	16,546,510	53%	Bankruptcy	NBE
41	LTD Georgian forest	28-11-14	1,283,840 GEL	1,283,840	4,816,595	4,945,047	1,658,947	6,603,994	73%	Bankruptcy	NBE
55	LTD Batumi N 1 Hospital	05-01-15	6,014 GEL	6,014	1,109,125	1,109,125	176,118	1,285,243	86%	Bankruptcy	NBE
	Revenue Claims between 89% and 50% of total claims			**2,060,856**	**27,889,788**	**28,018,240**	**13,021,287**	**41,039,527**	**68%**		
11	JSC "Kakheti Energodistribution"	05-08-11		34,650,000	586,448	586,448	15,664,697	16,251,145	4%	Bankruptcy	NBE
16	JSC "Kartligazi"	06-02-12	Cumulative value of property of the company is 314,802 GEL. Withal, has non-confirmed accounts receivable.	314,802	8,858,040	8,858,040	31,057,976	39,916,016	22%	Bankruptcy	NBE
18	LTD "Dariali"	11-06-12	GEL 98,180	98,180	104,922	108,888	1,760,844	1,869,732	6%	Bankruptcy	LTD "Eurokoni"
20	LTD "Kolkhi:	17-07-12	GEL 2,251,950	2,251,950	510,449	5,348,412	1,698,242	7,046,654	7%	Bankruptcy	LTD "Eurokoni"

24	LTD "New energy"	03-12-12	GEL 34,320,133.84	34,320,133	40,005,559	92,197,883	25,975,255	118,173,138	34%	Trusteeship	
26	LTD "Creative gaming solutions"	07-05-13	Cumulative value of property of the company is 70,536 GEL	70,536	255,908	255,908	1,080,412	1,336,320	19%	Bankruptcy	NBE
34	LTD "Sani"	03-02-14	GEL 50,844,713.42	5,844,713	4,025,902	26,496,396	7,936,611	34,433,007	12%	Trusteeship	
39	LTD "Ioli" supermarket	01-09-14	Accounts receivable could not be evaluated by the evaluation office. One car was assessed at 3,800 GEL.	3,800	174,348	174,348	12,317,555	12,491,903	1%	Trusteeship	
43	LTD "Delphi" 2011	30-12-14	Movable/immovable property worth of 31,506 GEL. Accounts receivable is not evaluated, total claim is GEL 59,231.33.	31,506	151,332	151,332	516,252	667,584	23%	Trusteeship	
45	LTD Referral Hospital	20-01-15	Evaluation in process. Accounts receivable was not precisely provided. Documentation is sealed up by the financial police. Anticipated value of claims - 453,091.74 GEL	453,091	117,510	117,510	1,785,668	1,903,178	6%	Bankruptcy	NBE
50	LTD "Zaraphkhana development"	20-03-15	Balance value of movable property is 369,392.98 GEL. Withal, has shares and real property, which have not been assessed yet.	369,392	4,270,789	4,270,789	7,759,583	12,030,372	36%	Trusteeship	
	RS Claims between 1% and 49% of total claims			**78,408,103**	**59,061,207**	**138,565,954**	**107,553,095**	**246,119,049**	**24%**		
1	Cooperative "Zemo Kedi"	11-12-97	Has property on balance sheet, but there is no documentation proving the bases for allocating these property on balance sheet. Creditors meeting should be called to end the bankruptcy proceedings				368,221	368,221	0%	Bankruptcy	NBE
2	JSC "Okros Satsmisi"	21-04-99		37,000		17,414,054	590,973	18,005,027	0%	Bankruptcy	NBE
3	Kolkhuri abreshumi/ Colchian Silk	15-04-02	Owns land that is not registered l in ownership.				3,847,448	3,847,448	0%	Bankruptcy	NBE
7	LTD "Elit pro"	15-06-10	Cashbox are assessed at 15 GEL and accounts receivable has not been evaluated.	15			10,659	10,659	0%	Bankruptcy	NBE
8	JSC "Hairy Textile Factory"	10-07-10	Being heard at court on unjust enrichment towards third parties				283,251	283,251	0%	Bankruptcy	NBE

14	JSC "Azotmsheni"	26-12-11	One of the properties is disputable. The case is heard by the Supreme Court of Georgia				1,357,885	1,357,885	0%	Bankruptcy	NBE
15	LTD Sky Georgia	01-02-12	Movable property – 1,500 GEL. Letters are sent for Accounts receivable. Two debtors already refused the debt.	1,500			8,563,658	8,563,658	0%	Bankruptcy	NBE
17	LTD "M.G. And Company"	15-05-12	Movable property: GEL 1,145 + accounts receivable GEL 52,725.34 that are not yet assessed	53,870		372,234	669,851	1,042,085	0%	Bankruptcy	NBE
19	JSC "Orioni"	13-07-12	GEL 30,000	30,000			11,000	11,000	0%	Bankruptcy	NBE
22	LTD "Bermukha"	18-09-12	Has cars registered in the name of the company merged with 'Bermukha' and the right to ownership of 'Bermukha' is not confirmed at the Ministry of Internal Affairs.			227,961		227,961	0%	Bankruptcy	NBE
27	LTD "Charnali Meurneoba "	24-06-13	Two cars and movable property is assessed at 12,456.20 GEL. Non-registered vehicles are to be evaluated. Has accounts receivables limitation periods whereof have been expired - total worth of 24,599 GEL	12,456		275,751	21,601	297,352	0%	Bankruptcy	NBE
28	LTD "Economy"	29-08-13	GEL 4,164 and accounts receivable GEL 61,102.61	65,267		83,403	149,792	233,195	0%	Bankruptcy	NBE
29	LTD "Marshe"	30-09-13	4,155,759.37 GEL	4,155,759		441,198	13,553,477	13,994,675	0%	Trusteeship	
30	LTD "Hodido"	11-10-13	GEL 31,500	31,500		281,832		281,832	0%	Bankruptcy	NBE
31	LTD "Dogan"	26-12-13	GEL 1,057,553	1,057,553		3,402,700	193,642	3,596,342	0%	Trusteeship	
36	LTD "Tiflis"	05-05-14	GEL 182,000	182,000	11,916	7,636,396		7,636,396	0%	Bankruptcy	Roin Migriauli

38	LTD "Mtkvari"	23-06-14	Accounts receivable worth of 20,208.60 GEL. Has 14 vehicles, wherefrom 6 has been assessed.	20,208		10,273,881	281,689	10,555,570	0%	Trusteeship	
40	LTD "Kaspi boarding house for children with disabilities"	29-09-14	Movable property worth of GEL 32,759	32,759		82,033	25,600	107,633	0%	Bankruptcy	NBE
46	LTD "Tskalkanali XXI "	16-02-15	Accounts receivable worth of 59,497,639 GEL.	59,497,639		37,217,063	332,452	37,549,515	0%	Trusteeship	
49	JSC ”Akhaltsikhe Regional Hospital”	16-03-15	In relation to budget has excess in amount of 23,245.10 GEL. Owns expired medicine under special control, which are to be disposed in accordance with the corresponding rule.				26,100	26,100	0%	Trusteeship	
54	LTD "Agroteqservice"	08-04-15	Has cars, which have not been assessed. Creditors first meeting is not called					-		Trusteeship	
	Zero RS Claims			**65,177,526**	**11,916**	**77,708,506**	**30,287,299**	**107,995,805**	**0%**		

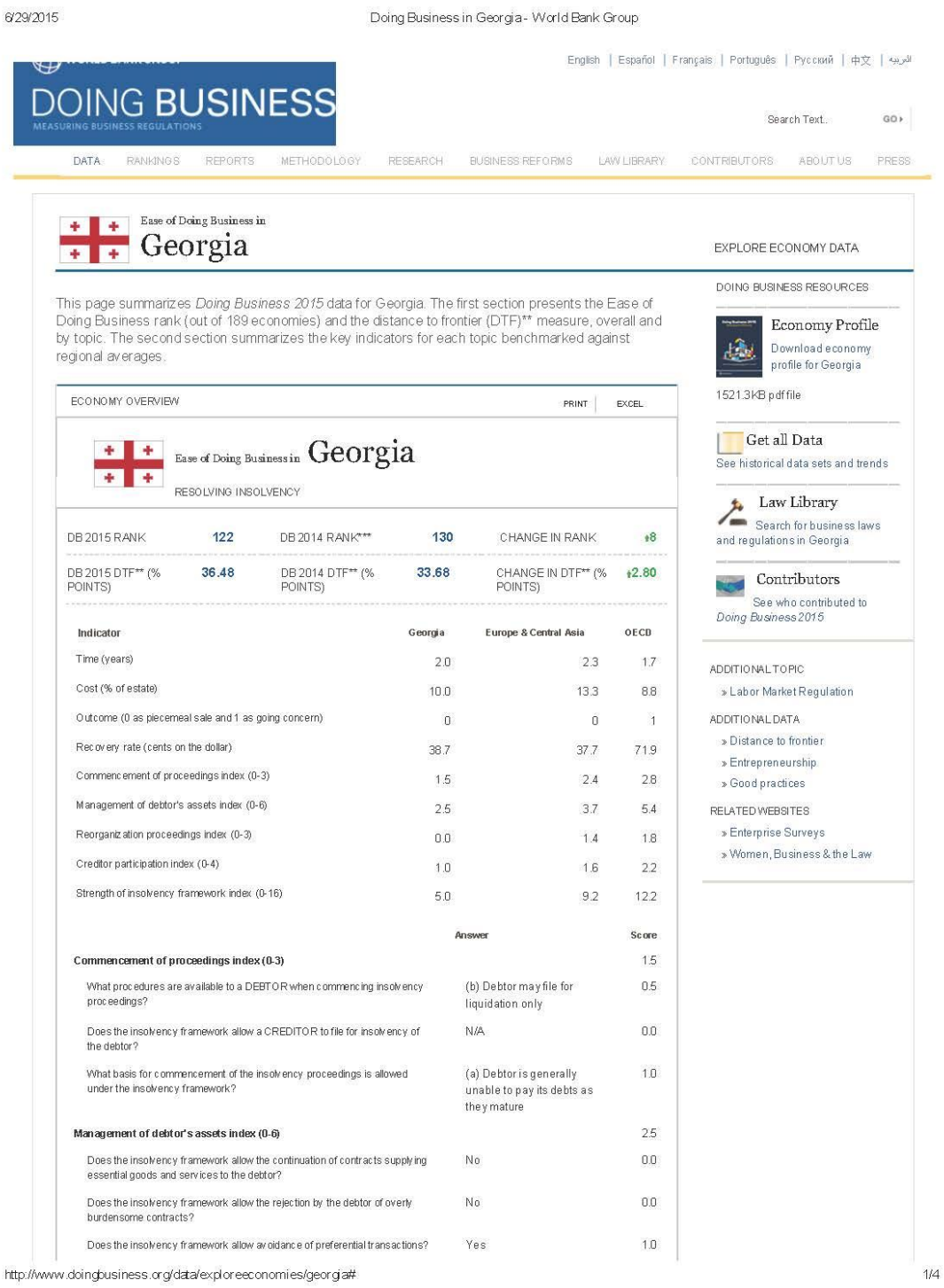
Appendix D: Extract From The Insolvency Law Of Serbia Regarding Rehabilitation Plans 2005

Article 128.

Measures taken to accomplish the reorganization may include:

1) Retention of all or part of the property of the bankruptcy estate;
2) Sale of property of the bankruptcy estate, with or without continuation of lien, pledge, or security interest; or transfer of the property in satisfaction of claims;
3) Closure of unprofitable operations or changing business activities;
4) Cancellation or reformulation of burdensome or unfavorable contracts or leases;
5) Deferment of debt payments, or providing for repayment by installments;
6) Modification of maturity dates, interest rates, or other terms of a loan or security instrument;
7) Full or partial debt forgiveness;
8) Satisfaction or modification of pledges, liens or security interests;
9) Conversion of unsecured loans into secured loans;
10) Pledge of unencumbered assets;
11) Conversion of debt to equity;
12) Obtaining new credit;
13) Obtaining new investment;
14) Challenge and invalidation of claims lacking in legal validity;
15) Curing of defaults;
16) Termination of employment;
17) Transfer of unencumbered assets in satisfaction of claims;
18) Amendments of the debtor's charter, by laws or other founding or governing documents;
19) Merger or consolidation with one or more entities;
20) Transfer of all or part of the property to one or more existing or newly formed entities;
21) Cancellation or issuance of new securities by the debtor, or of any new entity created;
22) Any other measures important for the realization of the reorganization plan.

Appendix E: Extract of Doing Business 2015



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Ease of Doing Business in
Georgia

EXPLORE ECONOMY DATA

This page summarizes *Doing Business 2015* data for Georgia. The first section presents the Ease of Doing Business rank (out of 189 economies) and the distance to frontier (DTF)** measure, overall and by topic. The second section summarizes the key indicators for each topic benchmarked against regional averages.

ECONOMY OVERVIEW PRINT | EXCEL

Ease of Doing Business in Georgia

RESOLVING INSOLVENCY

DB 2015 RANK	122	DB 2014 RANK***	130	CHANGE IN RANK	↑8
DB 2015 DTF** (% POINTS)	36.48	DB 2014 DTF** (% POINTS)	33.68	CHANGE IN DTF** (% POINTS)	↑2.80

Indicator	Georgia	Europe & Central Asia	OECD
Time (years)	2.0	2.3	1.7
Cost (% of estate)	10.0	13.3	8.8
Outcome (0 as piecemeal sale and 1 as going concern)	0	0	1
Recovery rate (cents on the dollar)	38.7	37.7	71.9
Commencement of proceedings index (0-3)	1.5	2.4	2.8
Management of debtor's assets index (0-6)	2.5	3.7	5.4
Reorganization proceedings index (0-3)	0.0	1.4	1.8
Creditor participation index (0-4)	1.0	1.6	2.2
Strength of insolvency framework index (0-16)	5.0	9.2	12.2

	Answer	Score
Commencement of proceedings index (0-3)		1.5
What procedures are available to a DEBTOR when commencing insolvency proceedings?	(b) Debtor may file for liquidation only	0.5
Does the insolvency framework allow a CREDITOR to file for insolvency of the debtor?	N/A	0.0
What basis for commencement of the insolvency proceedings is allowed under the insolvency framework?	(a) Debtor is generally unable to pay its debts as they mature	1.0
Management of debtor's assets index (0-6)		2.5
Does the insolvency framework allow the continuation of contracts supplying essential goods and services to the debtor?	No	0.0
Does the insolvency framework allow the rejection by the debtor of overly burdensome contracts?	No	0.0
Does the insolvency framework allow avoidance of preferential transactions?	Yes	1.0

DOING BUSINESS RESOURCES

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Does the insolvency framework allow avoidance of undervalued transactions?	No	0.0
Does the insolvency framework provide for the possibility of the debtor obtaining credit after commencement of insolvency proceedings?	Yes	1.0
Does the insolvency framework assign priority to post-commencement credit?	(a) Yes over all pre-commencement creditors, secured or unsecured	0.5
Reorganization proceedings index (0-3)		0.0
Which creditors vote on the proposed reorganization plan?	(c) Other, please specify	0.0
Does the insolvency framework require that dissenting creditors in reorganization receive at least as much as what they would obtain in a liquidation?	No	0.0
Are the creditors devided into classes for the purposes of voting on the reorganization plan, does each class vote separately and are creditors in the same class treated equally?	No	0.0
Creditor participation index (0-4)		1.0
Does the insolvency framework require approval by the creditors for selection or appointment of the insolvency representative?	Yes	1.0
Does the insolvency framework require approval by the creditors for sale of substantial assets of the debtor?	No	0.0
Does the insolvency framework provide that a creditor has the right to request information from the insolvency representative?	No	0.0
Does the insolvency framework provide that a creditor has the right to object to decisions accepting or rejecting creditors' claims?	No	0.0

**"The distance to frontier score shows how far on average an economy is at a point in time from the best performance achieved by any economy on each *Doing Business* indicator since 2005 or the third year in which data for the indicator were collected. The measure is normalized to range between 0 and 100, with 100 representing the frontier. Read more... ***Last year's rankings are adjusted. They are based on 10 topics and reflect data corrections.

		DOING BUSINESS 2015 RANK	DOING BUSINESS 2014 RANK***	CHANGE IN RANK
REGION	Europe & Central Asia			
INCOME CATEGORY	Lower middle income	15	14	↓ -1
POPULATION	4,476,900			
GNI PER CAPITA (US$)	3,570	DOING BUSINESS 2015 DTF** (% POINTS)	DOING BUSINESS 2014 DTF** (% POINTS)	CHANGE IN DTF** (% POINTS)
CITY COVERED	Tbilisi	79.46	79.61	↓ -0.15

Rankings | Distance to Frontier

TOPICS	DB 2015 Rank	DB 2014 Rank	Change in Rank
Starting a Business	5	4	↓ -1
Dealing with Construction Permits	3	3	No change
Getting Electricity	37	36	↓ -1
Registering Property	1	1	No change
Getting Credit	7	5	↓ -2
Protecting Minority Investors	43	43	No change
Paying Taxes	38	22	↓ -16
Trading Across Borders	33	31	↓ -2
Enforcing Contracts	23	23	No change
Resolving Insolvency	122	130	↑ 8

Starting a Business 5 | Dealing with Construction Permits 3 | Getting Electricity 37 | Registering Property 1 | Getting Credit 7 | Protecting Minority Investors 43 | Paying Taxes 38 | Trading Across Borders 33 | Enforcing Contracts 23 | Resolving Insolvency 122

Resolving Insolvency

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DB 2015 RANK	122	DB 2014 RANK***	130	CHANGE IN RANK	↑8

DB 2015 DTF** (% POINTS)	36.48	DB 2014 DTF** (% POINTS)	33.68	CHANGE IN DTF** (% POINTS)	♦2.80

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	Answer	Score
Commencement of proceedings index (0-3)		1.5
What procedures are available to a DEBTOR when commencing insolvency proceedings?	(b) Debtor may file for liquidation only	0.5
Does the insolvency framework allow a CREDITOR to file for insolvency of the debtor?	N/A	0.0
What basis for commencement of the insolvency proceedings is allowed under the insolvency framework?	(a) Debtor is generally unable to pay its debts as they mature	1.0
Management of debtor's assets index (0-6)		2.5
Does the insolvency framework allow the continuation of contracts supplying essential goods and services to the debtor?	No	0.0
Does the insolvency framework allow the rejection by the debtor of overly burdensome contracts?	No	0.0
Does the insolvency framework allow avoidance of preferential transactions?	Yes	1.0
Does the insolvency framework allow avoidance of undervalued transactions?	No	0.0
Does the insolvency framework provide for the possibility of the debtor obtaining credit after commencement of insolvency proceedings?	Yes	1.0
Does the insolvency framework assign priority to post-commencement credit?	(a) Yes over all pre-commencement creditors, secured or unsecured	0.5
Reorganization proceedings index (0-3)		0.0
Which creditors vote on the proposed reorganization plan?	(c) Other, please specify	0.0
Does the insolvency framework require that dissenting creditors in reorganization receive at least as much as what they would obtain in a liquidation?	No	0.0
Are the creditors devided into classes for the purposes of voting on the reorganization plan, does each class vote separately and are creditors in the same class treated equally?	No	0.0
Creditor participation index (0-4)		1.0
Does the insolvency framework require approval by the creditors for selection or appointment of the insolvency representative?	Yes	1.0
Does the insolvency framework require approval by the creditors for sale of substantial assets of the debtor?	No	0.0
Does the insolvency framework provide that a creditor has the right to request information from the insolvency representative?	No	0.0
Does the insolvency framework provide that a creditor has the right to object to decisions accepting or rejecting creditors' claims?	No	0.0

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***Last year's rankings are adjusted. They are based on 10 topics and reflect data corrections.

Note: Even if the economy's legal framework includes provisions related to insolvency proceedings (liquidation or reorganization), the economy receives 0 points for the strength of insolvency framework index, if time, cost and outcome indicators are recorded as "no practice".

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